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98TH CONGRESS *1st Session*	SENATE	REPORT No. 98-65

OMNIBUS BANKRUPTCY IMPROVEMENTS ACT OF 1983

REPORT

OF THE

COMMITTEE ON THE JUDICIARY UNITED STATES SENATE

[To accompany S. 445]

[Together with Additional Views]

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1st Session

SENATE

REPORT
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OMNIBUS BANKRUPTCY IMPROVEMENTS ACT OF 1983

APRIL 26, 1983—Ordered to be printed

Mr. THURMOND, from the Committee on the Judiciary, submitted the following

REPORT

[To accompany S. 445]

The Committee on the Judiciary, which considered the bill (S. 445) to make certain substantive changes to Public Law 95-598, the Bankruptcy Reform Act of 1978, having considered the same, reports favorably thereon as amended and recommends that the bill as amended do pass.

I. PURPOSE OF THE BILL

The purpose of the bill is to make certain substantive changes in Public Law 95-598, the Bankruptcy Reform Act of 1978.

II. INTRODUCTION AND HISTORY OF THE BILL

On July 12, 1978, the Committee on the Judiciary reported S. 2226, the Senate version of the Bankruptcy Reform Act of 1978. On September 20, 1978, H.R. 8200, with further amendments, was passed again by the House. On October 5, 1978, the Senate repassed H.R. 8200, with additional amendments. Finally, on October 6, 1978, the House accepted the final Senate changes and cleared the bill for signature by the President. On November 6, 1978, President Carter signed the bill and it became Public Law 95-598. On October 1, 1979, Public Law 95-598, styled the Bankruptcy Reform Act of 1978, went into effect.

In the 97th Congress, the Subcommittee on Courts, chaired by Senator Dole, held general oversight hearings on the Bankruptcy Reform Act of 1978 on April 3 and 6, 1981. As a result of those hearings, numerous amendments, largely technical in nature, were proposed which were passed by the Senate as S. 863, the Bankruptcy Amendments Act of 1981 on July 17 of that year. Additional hearings were held on October 29, 1981. During the course of these

hearings, judges, scholars, and bankruptcy practitioners testified as to the effectiveness of the new Code as it applies to consumer debtors and suggested improvements. Comments centered upon provisions in Chapters 7 and 13 governing redemption of collateral, reaffirmation agreements, Federal exemptions, preferential transfers, and a number of additional procedural sections of the Code. Witnesses also raised questions concerning the statutorily mandated criteria for determining eligibility for bankruptcy, and certain witnesses requested committee consideration of various proposals to require the bankruptcy court to evaluate the future earnings capability of consumer petitioners in determining eligibility for Chapter 7 relief, while others opposed these proposals. At the hearings held in October, 1981, the Subcommittee on Courts explored the ramifications of these proposals.

On December 16, 1981, all of the Subcommittee members introduced S. 2000, which was favorably voted out of the Subcommittee on Courts, with an amendment in the nature of a substitute offered by Chairman Dole accepted thereto by a unanimous poll of February 12, 1982. The bill was placed on the Committee calendar early in March and was before the committee for several weeks prior to vote, during which time committee staff conducted discussions on areas of concern to members. As a result of these discussions, a number of amendments were accepted to S. 2000 with modifications prior to final Committee action. The Committee approved reporting of the bill with amendments by voice vote on April 20, 1982. Senators Kennedy and Metzenbaum requested that their votes be recorded in the negative, and the clerk was so instructed. No action was taken by the full Senate on S. 2000 during the 97th Congress.

On January 25, 1983, additional hearings were held and on February 3, 1983, Senator Dole introduced S. 445, which contained the provisions of S. 2000, in addition to provisions addressing other areas of proposed substantive amendments. Further hearings were held on S. 445 on April 6, 1983.

After these hearings and as a result of further discussions among Committee members, S. 445 was amended in several important respects. Provisions requiring debtors to file, with the court, statements of projected future earnings and expenses and authorizing the bankruptcy courts to dismiss Chapter 7 cases if debtors could pay a reasonable portion of their debts out of future income were deleted. Provisions for debtor counseling by the court-appointed trustee were added. S. 445 was also amended to include language authorizing courts—acting strictly on their own motion—to dismiss a case where the granting of Chapter 7 relief would represent a substantial abuse of that chapter. Further technical and clarifying amendments were made to sections of the bill dealing with grain elevators, shopping centers, and other technical matters.

On April 19, 1981, the Judiciary Committee approved reporting of the bill with the amendments agreed to.

During the course of Committee action on S. 445, Senators Dole, Heflin, Metzenbaum, Kennedy, Leahy, Baucus and DeConcini each played a critical role in shaping the legislation and in developing moderating language enhancing protections for debtors affected by changes in the law provided for in the bill.

III. REASONS FOR THE BILL

In 1978, Congress enacted the Bankruptcy Reform Act, which included the Bankruptcy Code (containing the substantive law of bankruptcy) and a number of other provisions relating to bankruptcy administration. The Bankruptcy Reform Act was the first major revision of the bankruptcy laws of the United States since 1938, and its enactment was the culmination of an effort that extended over a number of years. The new Code resulted in numerous substantive changes in the law of bankruptcy as well as in the administration of debtor's estates. These new provisions generally have worked well and have had beneficial efforts. However, upon review of the testimony presented to the Committee, it was decided that the Reform Act could be improved to better serve both debtors and creditors, and reform inefficient procedures.

A. Consumer Credit Amendments

Since the passage of Public Law 95–598, the number of consumer bankruptcy cases filed each year has risen dramatically. The reasons for this increase have been in dispute; some witnesses before the Committee pointed to changes in the Code as being a principal cause of the increase, while others asserted that the rise in filings resulted from the combined effects of sluggish economic conditions, continued inflation, unemployment, and lawyer advertising permitted by the Supreme Court decision in *Bates* v. *State Bar of Arizona* (433 U.S. 350 (1977)). Without taking a position on this issue, the Committee has concluded that the amendments contained in S. 445 which relate to consumer petitions are appropriate regardless of the reason for the rise in bankruptcy filings.

(1) EFFECTIVE UTILIZATION OF CHAPTER 13

Concern was expressed by lenders testifying before the Committee concerning the limited use presently being made of debt repayment plans authorized under Chapter 13 of the Code.

Chapter 13 of the Code encourages debtors with regular income to pay that portion of their debts that they are able to pay through court-supervised debt consolidation plans. In some districts, the local bar and courts have made extensive utilization of the provisions of Chapter 13 to maximize return to the bankruptcy estate in those cases where the debtor has an ability to pay debts out of future income. However, in other States, use of Chapter 13 has been limited for a variety of reasons. One example of this disparity has been the experience in the Middle District of North Carolina, where Chapter 13 plans account for 86.1 percent of all individual filings; while in the District of Maryland, Chapter 13 plans comprise only 19 percent of all individual filings. One factor in the experience in the Middle District of North Carolina has been the existence of a debtor counseling plan which all individual bankruptcy petitioners participate in.

The desire to broaden the use of Chapter 13 resulted in the inclusion of language in S. 445, as introduced, which would have incorporated a "future income" threshold test in the law. Under this test, the courts would have systematically evaluated the ability of

debtors to pay a reasonable portion of debts out of future income. However, these provisions of S. 445 were deleted. The bill as amended provides for a counseling system for debtors to be administered by trustees appointed in Chapter 7 and Chapter 13 cases.

(2) SECTION 341(C) MEETING OF CREDITORS

A serious administrative problem that has arisen under the new Code is the provision in section 341(c) which prohibits the judge from presiding at, or attending, the meeting of creditors.

This provision was designed to help remove the judge from the day-to-day administration of bankruptcy proceedings. There was some concern that involvement of the bankruptcy judge in routine questioning of the debtor and administrative matters would result in the consideration of evidence outside the context of any dispute which the judge might later be called upon to decide. There was also concern that much of the evidence the judge might hear would be inadmissible in subsequent adversarial proceedings.

Unfortunately, however well intended this provision may be, there is evidence that the complete prohibition contained in section 341(c) hampers effective and speedy administration of the Bankruptcy Code. The new Code fails to recognize that under the prior bankruptcy law, the judge performed vital judicial functions at the meeting of creditors. Under new Code, which mandates the absence of the judge at all times, these important functions are ignored. Meetings must be continued while the parties seek resolution of such problems as disputes over the scope of examination of the debtor, deficiencies in the debtor's petitions and schedules, or, in consumer cases, disputes regarding redemptions and reaffirmations. Separate proceedings to resolve these disputes have resulted in consistent delay and substantial additional expenses for trustees, debtors, and creditors. Speed and efficiency are vital; delay results in devaluation of assets, unnecessary hindrance to financial rehabilitations, and prevents parties in interest from exercising their rights expeditiously.

Some witnesses emphasize the importance of keeping the judge removed from the day-to-day administration of the bankruptcy case: this is a burden that should not be placed on judges. Consequently, these parties opposed a requirement that judges should preside at all times in a meeting of creditors.

The Committee is of the opinion that the need for efficient and speedy administration of cases must be carefully balanced against the need to avoid overburdening the judge with administrative aspects of the case. The solution lies in providing the parties an opportunity to have disputes resolved at the meeting of creditors while affording the judge the flexibility in attendance at the meeting necessary to provide for efficient administration and performance of such judicial responsibilities as may be required under the Code, or necessary to a given proceeding, while, at the same time, avoiding undue involvement in purely administrative matters.

A requirement that the court convene the meeting would provide opportunity for parties to present immediate disputes to the judge for resolution. It would also allow for the elimination of the discharge and reaffirmation hearings—as discussed below—as the

functions performed at those hearings could be folded into the first meeting. The Committee bill so provides. The Committee is also concerned about reports that some bankruptcy judges are not exercising appropriate oversight of cases, particularly Chapter 11 reorganizations. Although the Reform Act was designed to relieve judges of the more mundane administrative work of bankruptcy, it was not intended that judges should completely ignore their oversight responsibilities. Bankruptcy matters do not consist solely of simple adjudicative functions, and bankruptcy judges should exercise control over all aspects of a case before them, including the monitoring of the activities of lawyers (particularly fee requests) to ensure that bankruptcy proceedings are not conducted solely for the benefit of counsel.

(3) VALUATION OF COLLATERAL ON SECURED CLAIMS

The existing provisions of the Bankruptcy Code (S. 506(a)) stipulate that the value of the property of a debtor's estate must be determined on the basis of the proposed disposition or use of that property. The Committee, after review of the testimony detailing experience with the valuation provisions of the 1978 Code, has concluded that the courts have, in too many cases, undervalued collateral property to an extent which denies adequate protection to secured creditors. Problems of proof which creditors face are compounded by judicial confusion over what standard should be employed—wholesale or retail, resale or straight line depreciation. Many courts have fixated upon wholesale resale at the appropriate standard, even for property with a high resale value in the retail market. Whereas the Bankruptcy Reform Act sought to encourage valuation on a case-by-case basis in focusing on the proposed use of the property in question as a determinant factor, the original intent of the Congress in this regard has not uniformly been carried into practice by the courts. Cf., In re *Crockett,* 3 B.R. 365 (Bk., N.D. Ill., 1980); In re *McLeod,* 5 B.R. 520 (Bk. N.D. Ga., 1980).

The Committee has concluded that further elaboration of congressional intent is required in order to dispel confusion. Thus, the proposed bill specifies the preference of the Code for use of a resale market standard, with the choice of wholsale or retail measurements of value to be determined by reference to the condition of the property and the debtor's proposed use or disposition thereof. In either case, the Committee bill encourages reference to trade publications as appropriate indicia of the market value of the property in question. The bill contemplates the utilization of other standards of valuation where such standards may provide for more equitable treatment of the parties than reference to the resale market would afford. For example, scheduled depreciation would be appropriate where a debtor seeks to redeem specialized manufacturing or processing equipment, peculiar to the debtor's business or profession and specialized needs, which has a limited or nonexistent resale value. In such situations, the debtor's proposed continued use of property of substantial utility militates against the use of any valuation scheme that does not provide a return to the creditor commensurate with the benefits afforded to the debtor by the redemption provisions of the section. Conversely, where the

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property in question has suffered substantial depreciation and is of limited use to either the debtor or creditor, liquidation value would be appropriately applied.

In all, the Committee believes that the provision of the bill will help to bring about more uniform valuation practices in the courts and allow for geater predictability in valuation determinations.

(4) DEBTOR DISPOSITION OF SECURED PROPERTY

Hearings before the Subcommittee on Courts revealed that one of the most severe problems created by the Code lies in the inadequate mechanisms for enforcement of rights of creditors which are not disputed. That is, the Code imposes such high "transaction costs" on the enforcement of certain rights, that the rights themselves become of little value. This is most clearly the case in connection with the rights of creditors who have a security interest or lien upon the debtor's property which is enforceable in bankruptcy. In most cases, these rights are themselves not disputed or questioned.

When the debtor files a bankruptcy petition, property which is collateral to a secured debt is frequently—in fact usually—retained by the debtor. The debtor generally has several options with respect to such property: He may claim the property as wholly or partially exempt, may seek to redeem the property, or may seek to retain the property by reaffirming all or part of the underlying debt. Or, the debtor may decide to surrender the property to the secured creditor. The trustee also has a potential interest in such property, although this interest is largely theoretical. In the typical case, the property will be worth less than the amount of the debt, and the trustee wil disclaim any interest in the property.

Under normal principles of commercial law, if a consumer does not pay a secured debt, the creditor can take either judicial or nonjudicial steps to recover the collateral. Unfortunately, when the debtor files a bankruptcy petition, the Code provides no orderly, expedited mechanism for enforcing the undisputed interest of the secured creditor. The debtor himself is not required to return the property or exercise one of the other options by a designated time. Theoretically, the secured creditor could request this relief at the meeting of creditors, but attendance at the meeting should not be necessary to get the debtor to elect one of his options.

Alternatively, the matter might be resolved by contacting the trustee, and some have argued that the trustee has a duty to pick up and deliver secured property. Testimony has indicated that in practice, nothing of the sort is taking place. The trustee often is unfamiliar with secured claims, and usually intends to abandon the property since its value is less than the creditor's lien; therefore, trustees are reluctant to expend estate assets to benefit secured claimants. Often, since there are minimal amounts available to pay priority claims, trustees would not be fully compensated for such efforts on behalf of secured creditors.

The secured claimant is barred from the kind of direct action permitted under normal principles of commercial law, as both before and after the meeting of creditors, the automatic stay bars direct communication with the debtor. This is a particularly acute

problem if the debtor is not represented by counsel, in which base there is no one to speak with at all, or if the debtor is represented by counsel who cannot be reached or who is not familiar with the particulars of the case involving the secured claimant. Prior to discharge, the automatic stay clearly prohibits any attempt to seize the property unless the creditor takes affirmative action in the court, which usually requires the filing of an adversary proceeding.

Evidence demonstrates that under the present Code provisions, there is a hiatus of from several weeks to many months during which the debtor has possession of the property, uses the property, and is not required to make any effort to resolve the interest of the secured creditor. During that time, the property will depreciate in value due to normal use, and may be lost or destroyed. Ultimately, if the interest is not resolved, the secured creditor must incur the considerable expense of bringing a separate proceeding to obtain relief from the stay so that the lien can be enforced. Creditors have stated that the costs of such a proceeding rarely are less than $350, and may be considerably more if several court appearances are required. Moreover, the debtor continues to retain and use the property for the time it takes to conclude the proceeding. This is a clear instance where the Code has imposed excessive costs on secured creditors who seek to enforce their undisputed rights to secure property. Ths costs are not imposed so that the debtor can exercise rights of his own; rather, there simply are no procedures for resolving such rights at an early stage of the proceedings at the least possible cost. The effect of the present scheme is to diminish substantially the rights of secured creditors, and, in many instances, entirely deprive them of their security.

This Committee recognizes that secured creditors have a substantial, and perhaps even paramount, interest in collateral property.[1] Accordingly, the debtor should, in the committee's view, be required to notify the secured creditor of his intentions with respect to the property within a reasonable period of time after the filing of the petition, and then, to perform his stated intention by the time of the meeting of creditors. In situations where there is a dispute over the respective rights of debtor and secured creditor, or in the rare case where the trustee will assert an interest of the estate in such property, the court can order the status quo to be maintained until any disputed matters are resolved.

(5) EXEMPTIONS

A number of witnesses expressed concern at the hearings over the federal exemptions as found in section 522(d). The new Code introduced a list of Federal exemptions into the bankruptcy law for the first time. Under prior law, property exemptions in bankruptcy proceedings were generally determined under State law. In promulgating a system of Federal exemptions, Congress was concerned that many state exemption laws had not been substantially revised in recent years to adequately serve the needs of individuals and to provide the fresh start contemplated in the bankruptcy proceeding. The historical purpose of exemptions was to provide a debtor with

[1] See *Mitchell* v. *W. T. Grant Co.*, 416 U.S. 600 (1974).

the basic necessities of life so that, after bankruptcy, the debtor could begin, or continue to lead, a productive life.

By enacting a list of federal exemptions and providing States with the option to specifically reject the list of federal exemptions, Congress sought to encourage the states to reexamine their exemption laws and bring them up to date. Congress clearly adhered to the view that the states were in the best position to determine what particular exemptions were needed for a "fresh start" in each particular locale and condition.

As with any new idea or concept, substantial problems have arisen with the federal exemptions. Three aspects of the list of federal exemptions were particularly criticized at the hearings as allowing a debtor to retain significantly more property than was needed to remain or become a productive member of society.

First, witnesses criticized the ability of joint petitioners to make separate elections regarding exemptions under the federal law or under the state law. In many cases this provision allows married couples to take unfair advantage of the most liberal provisions in both state and federal law: for example, one individual can take advantage of a liberal state homestead exemption designed to serve an entire family, while that person's spouse can take advantage of the liberal federal exemption regarding household goods.

Second, the provisions regarding household goods were particularly criticized by creditors. Section 522(d) of the Code allows a debtor to exempt any interest in any particular item of household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments that are held primarily for the personal, family, or household use of the debtor or his dependents, so long as the value of any specific item exempted does not exceed $200 ($400 in the case of a joint petition). No limit exists as to the total value of goods that may be exempted pursuant to the provision, thus allowing debtors to "stack" exemptions to maximize the total value of the exemption.

Third, the hearings brought out problems with regard to the so-called wild card exemption. Section 522(d)(1) of the Code provides that a debtor may exempt an interest, not to exceed $7,500 in value, in real property ($15,000 in a joint petition). Section 522(d)(5) provides an additional exemption of $400 plus any unused portion of the real property exemption. If the debtor does not own real property, he may use this wild card to exempt up to an additional $7,000 to $15,000 in any type of property owned. This wild card, which applies in addition to the eleven specific exemptions articulated in the Code, confers an unjustifiable, unnecessary "windfall exemption" upon the debtor in bankruptcy.

The Committee bill corrects these problems by placing an aggregate limit on the value of the exemption with regard to household goods and personal effects (allowing a total exemption of $4,000 for those types of property); by requiring individuals filing in joint or consolidated cases to elect either the federal or state exemptions together; and by placing a limit of $2,000 on the amount of unused homestead exemption that may be claimed by the debtor.

(6) EXCEPTIONS TO DISCHARGE: "LOADING UP"

Excessive debts incurred within a short period prior to the filing of the petition present a special problem: that of "loading up" in contemplation of bankruptcy. A debtor planning a file a petition with the bankruptcy court has a strong economic incentive to incur dischargeable debts for either consumable goods or exempt property. In many instances, the debtor will go on a credit buying spree in contemplation of bankruptcy at a time when the debtor is, in fact, insolvent. Not only does this result in direct losses for the creditors that are the victims of the spree, but it also creates a higher absolute level of debt so that all creditors receive less in liquidation.

During this period of insolvency preceding the filing of the petition, creditors would not extend credit if they knew the true facts. Nevertheless, it is often difficult to prove that such debts are fraudulent.

To correct this problem, the bill reported by the committee creates a rebuttable presumption that any consumer debt incurred within 40 days before the filing of the petition has been incurred under circumstances that would make the debt nondischargeable. This has the effect of shifting the burden to the debtor to demonstrate that the debt was not incurred in contemplation of discharge in bankruptcy. The committee believes that this provision, coupled with the modification of the standard applicable to awards of attorney's fees in proceedings to challenge dischargeability under S. 523—discussed below—will be sufficient to discourage this practice and provide an effective mechanism for remedial action. The committee intends that only that portion of a debt which is incurred within the 40-day time period shall be subject to the presumption; furthermore, debts incurred for purposes of providing support for the debtor and the debtor's dependents are not covered by the presumption.

(7) ATTORNEY'S FEES

The original congressional intent in the drafting of S. 523(d) of the existing Bankruptcy Code was to discourage frivolous objections to discharge of consumer debts, but not to discourage well-founded objections by honest creditors. The language of the subsection, however, makes the award of the debtor's costs and attorney's fees virtually mandatory in an unsuccessful challenge of a consumer debt. It has been interpreted as requiring the award of fees and costs even when the creditor acted in good faith. CF., *In Re Majewski,* 7 B.R. 904 (Bd. D. Conn. 1981). The net effect of this provision has been to preclude creditors from objecting to discharge of any consumer debt unless they are certain that the court will sustain the objection.

The Committee, after due consideration, has concluded that amendment of this provision to incorporate the standard for award of attorney's fees contained in the Equal Access to Justice Act strikes the appropriate balance between protecting the debtor from unreasonable challenges to dischargeability of debts and not deterring creditors from making challenges when it is reasonable to do so. This standard provides that the court shall award attorney's

fees to a prevailing debtor where the court finds that the creditor was not substantially justified in challenging the dischargeability of the debt, unless special circumstances would make such an award unjust.

(8) EFFECTS OF DISCHARGE ON SURVIVING LIENS

Historically, security interests and liens remain enforceable after bankruptcy unless the bankruptcy court has taken some action to affect or invalidate the creditor's interest. In some situations, however, the bankruptcy court will take no action with regard to property which is subject to security interests or liens. Although the Code appears to contemplate that the debtor will surrender such property to the trustee, who will then abandon the property or sell it, this frequently does not occur. Instead, the debtor will often simply retain the property, and continue making payments to the creditor. In other cases, the debtor may have made an agreement to redeem the property or reaffirm the debt according to a schedule, and subsequently defaulted on the payments.

In such situations, witnesses have indicated, it is unclear whether or not the injunction specified in section 524(a)(2) prevents a creditor from taking postdischarge action against the debtor to recover the collateral, and requires creditors to obtain postdischarge relief from the court. The committee bill would clarify this matter by statutory declaration that creditors need not obtain court authorization to enforce liens which have not been avoided in bankruptcy and thus remain valid and enforceable.

(9) REAFFIRMATION OF DEBTS

The Bankruptcy Reform Act of 1978 imposed significant procedural limitations on the debtor's ability to reaffirm debts that would otherwise be discharged in bankruptcy. All creditors—especially credit unions (which are democratically owned and controlled consumer financial organizations)—have experienced an unprecedented decrease in the number of reaffirmations made by borrowers in bankruptcy. As a consequence, increased losses must be borne by the consumers who repay their debts as well as the consumer saver. Industry figures for credit unions alone indicate that reaffirmation rates on both secured and unsecured loans, which ran as high as 70 percent before the new code, have remained around 10 percent since adoption of the 1978 Bankruptcy Reform Act.

Present practice under the Bankruptcy Reform Act

The code now requires the debtor to appear in court at the discharge hearing and have any reaffirmation approved by the bankruptcy judge. The court may approve a reaffirmation only if the agreement is made before the granting of the discharge; if it has not been rescinded within 30 days of becoming enforceable; and if the court has informed the debtor that reaffirmation is not required, and of the legal consequences of reaffirmation. The court must also find that the agreement does not impose undue hardship on the debtor or a dependent of the debtor and that it is in the best

interests of the debtor or entered into in good faith in settlement of litigation or to provide for redemption.

In practice, courts have interpreted these requirements in numerous ways. Some courts refuse to approve any reaffirmation agreement, while others provide a limited review of the fairness of the agreement; and a number approve reaffirmation agreements in mass at the discharge hearing. In almost all cases, the court will not approve a voluntary reaffirmation of an unsecured debt. Therefore, many lenders, but especially credit unions which lend to a large degree on an unsecured basis, have been significantly adversely affected by the provisions of the code dealing with reaffirmation.

Under the 1978 code, the court's intervention and admonition that reaffirmation is not required now comes at the end of the bankruptcy process. This greatly diminishes the impact of the warning and enhances the obligation of the judge to scrutinize each bankruptcy agreement under the rigid reaffirmation requirements of the 1978 Bankruptcy Reform Act. Also, the frequently long delay between the filing of the petition and the reaffirmation/discharge hearing increases the likelihood that the creditor will realize a loss not intended by the debtor. This is a particularly troublesome result where a voluntary reaffirmation has been made by the debtor and the bankruptcy court, because of its interpretation of the code, refuses to approve the reaffirmation. Testimony of industry spokesmen indicates that credit union members frequently approach the credit union after filing for bankruptcy and enter into voluntary reaffirmation agreements, only to have the court deny the approval required. Many credit unions, frustrated by these denials, no longer even expend the effort necessary to secure reaffirmations under the present system.

Impact of automatic stay on reaffirmations

The committee believes that the automatic stay provided under section 362 of the Bankruptcy Reform Act of 1978 has drastically reduced, if not eliminated, the abusive practices encountered under the pre-1978 bankruptcy law. Creditors can no longer independently contact debtors to encourage them to reaffirm debts because such contact is prohibited by the code.

The proposals placed before the committee to remedy defects in the reaffirmation process would not alter the prohibitions on contact with the debtor. Therefore, the major protection provided under the code to prevent coercive reaffirmation remains intact. Reaffirmations obtained presently that are subsequently denied by a bankruptcy court are, in fact, truly voluntary reaffirmations.

Committee bill

The committee proposal envisions a signed agreement or order between the debtor and the creditor that is filed with the bankruptcy court. The agreement must inevitably be voluntary because contact between the debtor and creditor is otherwise prohibited by the automatic stay, and because of the court's obligation to advise the debtor at the first meeting that such agreements are voluntary in nature. The debtor, therefore, has to initiate the contact with the creditor concerning the preexisting debt. In cases where the

debtor is represented by counsel, the debtor's counsel would clearly provide an additional buffer to ill-advised reaffirmations. In cases where the debtor appears pro se, the bill will still require court approval of such agreements. Also, under the committee proposal, the debtor will receive the admonition regarding reaffirmations at the first meeting of creditors. Those warnings will be given by the bankruptcy judge, thus reminding each debtor at an early stage that bankruptcy is a judicial proceeding and that court protection from abuse is always available.

The proposal also provides a 60-day cooling-off period during which time the debtor may rescind the reaffirmation agreement by written notice. This extension of the present 30-day period insures that the debtor has an adequate opportunity to judge the impact of a periodic payment on the "fresh start" provided by the 1978 Bankruptcy Reform Act.

The provision for filing the agreement with the court is designed to, (1) lower the cost to the parties of the transaction, (2) minimize the potential burden on the bankruptcy court, and (3) insure that the court is properly informed of such agreements so that it may exercise its equitable powers to protect the debtor from overreaching creditors. In this respect, the language of the bill makes clear the intent of Congress that such agreements be subject to the exercise of the court's equitable jurisdiction as amplified in section 105 of the Code. While the purpose of the bill is to abolish the cumbersome "Miranda warning" approach of the 1978 act, the committee nevertheless intends that the Court review will constitute more than a "rubber stamp" of the agreement. The key consideration should be ensuring that the debtor will not suffer an undue hardship by the execution of any reaffirmation agreements. In short, the debtor's fresh start should not be impaired by any such agreement.

It is anticipated that, in the vast majority of cases, the obligations of the court may be adequately discharged by brief inquiries to counsel and the debtor. Where the debtor and the debtor's counsel are in agreement that the execution of the agreement is beneficial to the debtor, the presumption should be in favor of ratification of the agreement.

In all, the new section is designed to encourage the prompt execution and implementation of good faith reaffirmation agreements by eliminating the cumbersome and unnecessary prior approval procedures which inhibited debtors and creditors from consummating mutually acceptable debt retirement arrangements. The Court, of course, has the authority and obligation to disallow reaffirmations which were not entered into voluntarily by the debtor or which were entered into without an understanding on the part of the debtor that the debtor is not obligated to enter into the agreement. Also, the legal effect and consequences of the agreement and a default thereunder must be explained to the debtor, including the fact that the debtor has a right to rescind the agreement within sixty days after it is filed with the court (or after the court approves in the case of a *pro se* debtor).

Many debtors feel a special obligation to a certain lender or financial institution, such as a credit union, and desire to repay those debts regardless of their ability to obtain a discharge under

the Bankruptcy Code. While the Bankruptcy Reform Act of 1978 has effectively eliminated the abuses encountered in the reaffirmation area under the prior law, it has also eliminated almost all voluntary reaffirmations in many courts.

The Committee proposal would again permit voluntary reaffirmations while preserving the major protection in the 1978 law against abuses by not permitting a creditor to initiate contact with the debtor to obtain a reaffirmation. It is the Committee's view that the enactment of the 1978 Bankruptcy Reform Code was not designed to eliminate or even substantially restrict truly voluntary reaffirmation between a debtor and a particular creditor; and the fact that the Code has had this effect makes the amendment necessary.

(10) PREFERENCES

Many witnesses at the hearings expressed dissatisfaction with section 547 of the Code which covers situations in which the trustee in bankruptcy may recover a "preference." Under both the old and the new law, a trustee can recover certain prepetition payments to creditors where certain conditions place the payment in the category of a preferential transfer.

The Reform Act made two major changes to the provision on preferences that were criticized at the hearings. First, the new Act creates a presumption that the debtor is insolvent for a period of 90 days before the filing of a petition. Insolvency at the time of the payment is one of the conditions a trustee must demonstrate to recover a payment made to a creditor. The presumption was added to relieve the trustee of a difficult burden of proof. Because books or records of a debtor are generally in less than perfect condition, it was often difficult under the old law for the trustee to demonstrate conclusively that the debtor was insolvent.

Creditors taking routine payments on installment debts in good faith, believing the debtor to be solvent, have been faced with the same difficult burden that was previously placed on the trustee. Witnesses felt that by creating a presumption that one element of a preference was satisfied, Congress effectively eliminated that element. It was noted also that, in many chapter 11 reorganizations, the presumption may be inaccurate.

Second, the witnesses criticized the change in the new code which eliminated the requirement that the creditor have reasonable cause to believe that the debtor was insolvent at the time of transfer as a condition to the trustee's recovery of a prepetition payment. Many instances were reported in which payments received in good faith by creditors were the subject of recovery actions. In consumer cases, creditors were being required to return payments received from consumers who were completely current in their obligations to the creditor at the time of the petitions.

The committee recognizes the severe problems that have arisen with preferences, and feels that the burden has been shifted too far and now unfairly discriminates against the good faith creditor. This shift of the burden might be justified if the evidence suggested that the recovery of preference items resulted in significant increases of distributions from the estate. However, for the most

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part, the administrative expense of these collections, particularly in individual proceedings, results in very little being distributed to creditors.

The bill does not eliminate the presumption of insolvency. However, it does require that the creditor must have had reasonable cause to believe that the debtor was insolvent at the time of transfer before a preference can be established. In addition, the bill eliminates the 45 day limitation on the exception to the trustee's avoidance powers contained in Code section 547(c)(2). The committee feels that these changes will produce a better balance between the burden placed on creditors and trustees. The committee does not pass final judgment on the need for the presumption of insolvency, but feels that the code can benefit from a period of experience with the changes contemplated in S. 2445 before that question is finally determined.[2]

(11) REDEMPTION OF EXEMPT PROPERTY SUBJECT TO NONPURCHASE MONEY SECURITY INTERESTS

Section 522(f)(2) of the Code invalidates nonpossessory, nonpurchase money security interests in property which is exempt and which consists of household goods and personal articles, tools of the trade, and professionally prescribed health aids. This provision was based on the view that such property often had a high replacement cost for the debtor and might aid his fresh start, while it also had a low resale value to the creditor. Thus, invalidating the creditor's security interest seemed to offer substantial benefits at little cost.

Experience under the Code has shown that the invalidation of nonpurchase money security interests in such property has had several significant and detrimental effects on both consumers and creditors. First, consumers who previously qualified for credit only because they could post security in the form of household goods or tools of the trade, now are being denied credit altogether. Moreover, creditors who previously extended credit to such persons have withdrawn from these segments of the consumer credit market, thus decreasing the availability of consumer credit. (See statement of Robert Evans before the Subcommittee on Courts, Oct. 29, 1981

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[2] Not all unintended effects have been the result of the Code itself; some have resulted from erroneous interpretations of the Code. An interesting example of this brought to the committee's attention is the case of *Twist Cap. Inc.* v. *Southeast Bank of Tampa*, 1 B.R. 284 (D. Fla. 1979), in which the court granted a temporary restraining order prohibiting payment under a letter of credit which the debtor had obtained for the benefit of a creditor.

This case raised the questions of (1) whether a letter of credit (or in some transactions a guarantee by an insurance company) is property of the bankruptcy estate and (2) whether the fact that the guarantor is secured while the creditor is not makes the payment a preference.

The first issue, regarding property of the debtor, was resolved in the manner contemplated by Congress in the case of *In re Marine Distributors, Inc.* 522 F. 2d 791 (9th Cir. 1975) which determined that a letter of credit is not property of the estate.

The second question has been more recently resolved in the case of *In re Hart Ski Mfg. Co., Inc.*, Bankruptcy No. 3-8-200, Adv. Op./No. 80-45, (unreported memorandum decision of Judge Dim), holding that the transfer of the debtor's property occurred when the guarantees were issued and the guarantor received the right to collateralize its obligation under the guarantees, and not when payment on the guarantee occurred. For that reason, no preference occurs when the guarantor pays the unsecured obligation of the debtor under its secured letter of credit as would have occurred in *Twist Cap.* Since a payment under the letter of credit is not property of the estate nor a preferential payment, the court should grant no injunctive relief—particularly a temporary restraining order—because of the timeliness expectations of the beneficiary of the letter of credit or guarantee. This issue is dealt with in the technical amendments contained in this bill.

hearings.) This result contradicts the strong congressional policies in favor of making credit more widely available to all segments of the population. Second, creditors often have insisted on new forms of security or protection which would not be invalidated under section 522(f)(2): for example, creditors may seek second mortgages, cosigners, and security posted by cosigners. Finally, the committee's attention was directed to cases where the debtor borrowed against equity in items of property of this type having high market value (such as antique furniture). In such cases, the effect of the new Code is to impair the creditor's security in property which has significant economic value and which does not fall within the high replacement/low resale rationale of section 522(f)(2). (See Rice, Wiese, Landers testimony, p. 61, April 1981 hearings.)

The Committee bill resolves these competing interests by eliminating the avoidance of non-possessory, non-purchase money liens on household goods. Non-possessory, non-purchase money liens on tools of the trade, implements and professional books having a value of $1,000 or less may still be avoided. Avoidance of liens on health aids is left intact under the Committee bill.

Complementing these changes are provisions allowing the debtor to redeem non-avoidable liens over a period of five years. Where the Court finds that a debtor has no reasonable ability to redeem the property affected by a non-avoidable lien, and that the requirement of redemption would impose undue hardship, it may exempt the property completely from the operation of the lien.

(12) AUTOMATIC RELIEF FROM STAY ON CODEBTOR OBLIGATION IN CHAPTER 13

Section 1301 stays the creditor's efforts to collect a consumer debt from codebtors, cosigners or guarantors upon the filing of a chapter 13 petition. The creditor is entitled to have the stay lifted to the extent the plan does not propose to pay the debt or to the extent that the codebtor, cosigner or guarantor received consideration for the debt. The lifting of the stay on those grounds, however, is not automatic and requires a request before the court and notice and a hearing. Creditors maintain that the significant costs and expenses which are involved in this procedure can be eliminated without undue burden for the debtor or codebtor by requiring a 10-day advance notice to the debtor and the codebtor after which time the stay, absent an objection, would be lifted. The committee believes that this constitutes a reasonable proposal which will help minimize unnecessary expenditures of time and financial resources by the courts and creditors alike. If an objection to the proposed action against the codebtor, cosignor or guarantor is lodged by the debtor, or codebtor, notice and hearing as provided for in present law will precede any collection action.

(13) COMMENCEMENT OF PAYMENTS IN CHAPTER 13

Under present law, payments under a chapter 13 plan frequently do not begin until the plan is confirmed. This sometimes takes several months or longer. Unfortunately, when the payments do not begin promptly, the debtor becomes accustomed to living on money that will not be available once the plan becomes operational; and it

may be very difficult for the debtor to scale down expenditures once the plan begins. Indeed, chapter 13 trustees report that there is much greater incidence of compliance with the plan when payments begin promptly, and prompt commencement is required in some districts by local court rules. Moreover, the period between the filing of a plan and confirmation provides a good test of whether the debtor will be able to carry out the plan, or whether some modification is necessary.

In testimony before the Committee it was pointed out that:

> In a number of districts the debtors are expected to, and do, commence making payments to the trustee immediately upon the filing of the case; and we suggest that adequate authority for such procedure is presently in the statute. However, the language contained in section 1325(b) has led some courts to conclude that the debtor *should not* make payments immediately upon filing of the case. (Emphasis added.)[28]

There appears to be broad agreement that payments to the trustee should commence immediately upon filing of the plan.

(14) TREATMENT OF NONDISCHARGEABLE AND COSIGNED DEBTS IN CHAPTER 13 PROCEEDINGS

1. Nondischargeable debts

Section 523(a) of the Bankruptcy Reform Act specifies a number of claims which are not dischargeable in bankruptcy. This means that the debtor remains obligated to pay such claims, and they may be collected from post-petition earnings and property where proceedings are instituted under the provisions of chapter 7.

In chapter 13, however, all of these claims are dischargeable except those for alimony and child support claims (see section 1328(a)(2)), and they are dischargeable even if the debtor proposes to pay little or nothing in satisfaction of the claims; for, although section 1325(a)(4) requires unsecured creditors to receive as much in chapter 13 as they would in chapter 7, this has been interpreted by courts to allow chapter 13 claimants only as much as they would receive from a liquidation of the debtor's present property. Cf., *In re Marlow,* 3 B.R. 305 (Bk., D.N.D. Ill. 1980); *In re Jenkins,* 6 BCD 378 (Bk., D. Colo. 1980); *In re Thorson,* 6 B.R. 678 (Bk., D.S.D. 1980). Such a standard does not, of course, consider the fact that creditors with nondischargeable claims have access to postpetition earnings and property, and in the committee's view it is inadequate to encourage satisfaction of these important claims. As witnesses emphasized, the provisions quoted above, as presently written, effectively undermine section 523(a) in several important respects. First, they permit persons with nondischargeable claims effectively to avoid section 523(a) by filings a chapter 13 plan providing for small payments to creditors with nondischargeable claims. *In re Marlow, supra* (1 percent); *In re Jenkins, supra* ($1). Second, they encourage debtors to propose the smallest possible chapter 13 payout, for, under chapter 13, if a debtor proposes a 10 percent

[28] Testimony of Claude Rice, Oct. 29, 1981; Subcommittee on Courts Hearing.

payout and completes the plan, most of the nondischargeable debts are fully discharged. Anomalously, if the debtor proposes a 75-percent plan payment of nondischargeable debts and receives a hardship discharge under section 1326(b) after paying 25 percent of the claim, the claim is not discharged. Under these circumstances, debtors with nondischargeable claims only logically propose the lowest payout to assure completion of the plan, and dischargeability of the otherwise nondischargeable claims in the result. Third, because nondischargeable claims are not allowed special treatment in chapter 13, section 1322(b) probably forbids the creditor with a nondischargeable claim from being treated differently from other unsecured creditors.

The committee bill corrects these problems by (1) statutorily encouraging satisfaction of S. 523(a) debts in chapter 13, (2) conforming the treatment of such debts provided for in chapter 13 to that accorded them in chapter 7, and (3) allowing the chapter 13 plan to discriminate between section 523(a) debts and other debts scheduled so as to facilitate their integration into a workable plan.

The proposed bill accomplishes these objectives through four principal amendments. First, it contains a statutory recognition of the desire of the Congress that nondischargeable debts to retired in chapter 13 proceedings where possible by explicitly providing for their inclusion in a wage-earner plan. This is accomplished by amendment to section 1322(a), which sets forth the authorized contents of a plan. Second, it amends section 1322(b) to allow a separate scheduling of section 523(a) debts in the plan without invoking the antidiscrimination provisions of that section. Third, it amends section 1328(a)(2) so as to prohibit the discharge of unpaid section 523(a) debts after completion of a plan. Finally, and as an incentive to scheduling of section 523(a) debts in a chapter 13 proceedings, the bill would allow hardship discharge of section 523(a) debts that were proposed to be paid as part of an aborted plan (this being accomplished by amendment to section 1328(c)(2)).

2. Cosigned debts

A number of cases have considered whether claims involving codebtors may be classified separately from other claims. Thus far, the majority of cases have refused to permit such classification on the ground that codebtor claims are not different than other claims. See, for example, *In re Utter,* 3 B.R. 369 (Bk. W.D.N.Y. 1980); *In re Montano,* 4 B.R. 535 (Bk. D.D.C. 1980).

Although there may be no theoretical differences between codebtor claims and others, there are important practical differences. Often, the codebtor will be a relative or friend, and the debtor feels compelled to pay the claim. If the debtor is going to pay the debt anyway, it is important that this fact be considered in determining the feasibility of the plan. Somethines, the codebtor will have posted collateral, and the debtor will feel obligated to make the payment to avoid repossession of the collateral. In still other cases, the codebtor cannot make the payment, and the effect of nonpayment will be to trigger a chapter 7 or chapter 13 petition by the codebtor, which may have a ripple effect on other parties as well. For these reasons, separate classification is often practically necessary.

Courts under both the present Act and the former law have emphasized that plans must be realistic. For example, courts have refused to confirm plans which the debtor could not possibly perform; have insisted on realistic estimates of expenditures; and have considered debts which the debtor proposes to pay outside the plan in determining feasibility. See, for example, *In re Washington*, 6 BCD 1094 (Bk., E.D. Va. 1980). This approach is eminently sensible. No purpose is served by confirming a plan which the debtor cannot perform. If, as a practical matter, the debtor is going to pay the codebtor claim, he should be permitted to separately classify it in chapter 13. A result which emphasizes purity in classifying claims does so at the price of a realistic plan. Neither debtors nor creditors benefit from such a rigid approach, and the Committee has determined that statutory authority to separately schedule such debts will contribute to the success of plans contemplating repayment of same. Accordingly, this authority is provided for in the proposed bill by amendment to section 1322(b)(1).

(15) LENGTH OF CHAPTER 13 PLAN

The question of length of a plan is also cause for concern. In the past decade, the financial community has witnessed an increasing willingness of consumers to incure longer term debt for transactions other than first mortgages on residential property. For example, the maturities of new car loans often are 4 to 5 years, and the maturities on credit sales of appliances often are 3 years.[3] Many consumers have made second mortgage loans using the equity in their homes, and maturities usually extend over 5 to 10 years or more. A consumer who files a chapter 13 petition is, in effect, asking that debt which essentially is short term debt be converted into longer term debt. Given the consumer's willingness to incur relatively long maturities for traditionial consumer loans, it may be reasonable to allow a longer maturity when short term debt is being converted into longer term debt than present chapter 13 practice allows.

Convincing testimony was offered by Claude Rice, Esq., at the October 29, 1981 hearings held by the Subcommittee on Courts, which indicated that the present 3-year standard for confirmation—first adopted in 1938—may be working substantial hardship on both debtors and creditors alike. Mr. Rice, a chapter 13 trustee for over 25 years and an executive of a company which provides data processing services to courts, attorneys, and trustees in the processing of bankruptcy cases particularly chapter 13 cases provided the subcommittee with computer printouts summarizing the results of over 138,000 cases during the 20-year period from 1960–1981. He observed that:

> A mandatory limit is a restriction on the debtor's ability to propose a feasible plan commensurate with his ability to pay. The short time limit is not a benefit to the debtor. It

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[3] According to Federal Reserve Board data, new auto contracts in November 1980, written by finance companies averaged 44.8 months. Mobile Home Loan contracts averaged 137.2 months and other goods, 24.5 months.

> merely forces well intentioned debtors to attempt a payment schedule greater then they are able to maintain.
>
> The statistics which we have maintained have consistently indicated for over 15 years that those debtors whose cases are dismissed or converted to liquidation cases have attempted to pay from $5 to $10 per week more than those debtors whose cases are successfully completed.
>
> In this connection, we attach a series of reports and charts which display the effect of limiting the length of the debtor's plan. Briefly stated an extension of the period of time which the plan is allowed to extend can substantially reduce the debtor's monthly payments and improve the net return to creditors.[4]

In a second summary of 35,000 cases closed in 1980–1981, Mr. Rice observed:

> Analysis of this data has always indicated that those debtors who were unable to complete their plans, those debtors whose plans were dismissed or converted to liquidation cases, were those debtors whose proposed payments were 5 to 20 percent greater than the payments proposed by those debtors who completed their plans. . . . In both of these summaries it should be observed that the debtors whose plans were successfully completed averaged more than 36 months and always provided for smaller monthly payments than those cases which were dismissed or converted to liquidation cases.[5]

Thus, from the debtor's standpoint, a plan permitting lower payments, realistically commensurate with disposable income and made for a longer period of time, is more likely to succeed.

Likewise, there are serious limitations imposed by the 3-year limit on the ability of debtors to pay unsecured debt. According to the analysis of the 35,000 cases provided by Mr. Rice, trustee's fees and expenses, priority items, and secured claims account for about 65 percent of the total funds available in a 36-month plan, leaving less than 35 percent available for unsecured creditors. If the actual funds available in a 36-month plan were made available at the same rate for longer periods then, according to the analysis, approximately 77 percent of unsecured debt would be paid in 48 months, and 100 percent would be paid in 55 months.

Clearly, the chapter 13 debtor's priority obligations are frequently so great that—on the average—they crowd out the repayment of all but a small portion of the unsecured debt. The question arises whether, taking into account the relatively high proportion of unsecured debts found in chapter 13 proceedings, equitable treatment is being accorded unsecured debtors. If it is not, it may well result in a profound and adverse effect on the availability of unsecured consumer credit. As Mr. Rice concludes:

> It is obvious from examining these charts that the length of time for which the debtor's plan may be proposed

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[4] Rice testimony, Oct. 29, 1981, Ser. J-97-11, pt. 2, p. 44.
[5] Rice testimony, Ser. J-97-11, pt. 2, p. 51.

> has a profound impact both on the amount of money that the debtor needs each pay day to meet the requirements of a plan or the amount of money which creditors will be paid or both. * * *
>
> It should be noted that the statute presently requires the secured creditors to retain their liens and be paid under the plan amounts not less than the value of their security. It is the unsecured creditors whose interest can be adversely affected by a chapter 13 plan. This is the group that represents the merchants, bankers, credit cards, doctors, and other small business interests. These claims represent only 51 percent of the dollars claimed but over 73 percent of the number of creditors involved.[6]

The committee believes that lengthening the standard plan term from 3 to 5 years will not only enhance debt recovery in chapter 13 cases, but will also result in lower failure rates for debtors who desire to make a good-faith effort to repay their obligations. The committee proposal will, at the same time, permit a debtor who desires to expedite the retirement of debts to do so by allowing termination of the plan earlier than 5 years where a reasonable portion of unsecured claims have been satisfied.

(16) STANDARD FOR CONFIRMING CHAPTER 13 PLANS

In theory, chapter 13 is consistent with the basic premise upon which consumer credit is granted: The debtor proposes a plan to pay his debts over a period of time and, almost always, out of future income. Chapter 13 proceedings thus look to future income—the very asset upon which credit is granted in the first place—as a source for repayment of debt. The committee believes that chapter 13 should therefore be consistent with the income-based approach to consumer credit.

Unfortunately, the promise of chapter 13 has only been partly realized. The present chapter 13 provisions do not articulate any meaningful standards for determining what portion of the debtor's income should be devoted to the plan, and for how long the plan should last. The absence of such meaningful standards has had an important impact on the ability of creditors to obtain meaningful recoveries in chapter 13 cases.

Income devoted to the plan

Chapter 13 does not contain any standard which specifies how much of the debtor's future income should be devoted to the plan. The only provisions which bear on this issue are found in section 1325(a)(4), which requires that creditors receive at least as much in a chapter 13 case as they would receive in a chapter 7 liquidation, and section 1325(a)(3), which requires the plan to be "proposed in good faith."

In both theory and practice, the requirement that creditors in a chapter 13 case receive at least as much as they would receive in a chapter 7 liquidation, is not a meaningful standard. In theory, the liquidation standard necessarily looks to present assets as a source

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[6] Rice testimony, Ibid, p. 54.

for paying debts. The fact that debts cannot be paid out of assets has no bearing upon the extent to which they can be paid out of future income. In practice, chapter 13 creditors usually would receive little or nothing in a chapter 7 case because the debtor has little or no non-exempt property for distribution. Indeed, some courts have turned this standard against creditors, and used it as the basis for confirming chapter 13 plans providing for no payments or nominal payments to creditors. These courts reason that since creditors would have received nothing in a chapter 7 case, they have little cause to complain if they receive nominal payments under a chapter 13 plan.[7]

The good faith standard provides little further protection. The standard is unduly vague, and there is no legislative history, or supportive provisions in chapter 13, which would help to give it content. Indeed, it is not even clear whether good faith, as contemplated in the statute requires some objectively determined portion of the debtor's future income to be devoted to the plan, or whether subjective good faith (a pure heart) is all that is necessary.[8]

The Code does not provide any target for the portion of debt which should be repaid, nor does the Code even provide that repayment of debt should take precedence over expenses for non-necessary or luxury items.[9]

Given such vague and uncertain standards, it is not surprising to find widely different approaches among bankruptcy courts. Some courts have set a benchmark test of a 70-percent payment, while others have specifically rejected guidelines.[10] Some courts reportedly press debtors' attorneys for plans paying 50–100 percent of claims, while others intimate that attorneys for debtors who propose to pay more than 10–25 percent have not provided effective representation to their clients. Some courts seem to consider the debtor's ability to pay as crucial, whereas others have refused to confirm low payment plans even when they represent the debtor's best effort. Throughout the country, courts regularly are confirming plans which provide for payment of 10–25 percent of claims, and occasionally nothing at all.

A chapter 13 proceeding involves substantial benefits to the debtor who is able to retain his property, avoid most nondischargeable debts, and cram down debts of secured creditors. The *quid pro quo* for such benefits would seem to be a substantial effort by the debtor to pay his debts. Of course, the first criterion in such cases must be the debtor's obligations to support himself and his family. But beyond that, it is necessary to have a definite standard delineating how much of the debtor's future income should be committed to the plan.

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[7] See *In re Stollenwerck*, 8 B.R. 297 (M.D. Ala. 1981); *In re Cloutier*, 3 B.R. 584 (Bk. D. Colo. 1980).

[8] See *In re Stollenwerck*, supra (debtor's proposal to pay one-half of excess disposable income is in good faith); *In re Sudduth*, 9 B.R. 405, 407 (Bk. N.D. Ga. 1981) (allegations that payments are insignificant in light of available disposable income are not "material to a determination of . . . good faith"). After an exhaustive examination of the meaning of good faith, Judge Norton concluded that it simply meant "honesty of purpose" and "full and complete disclosure." On the other hand, good faith did not have a quantitative meaning, nor did it require the debtor's best effort. *In re Wiggles*, 7 B.R. 373, 375–80 (Bk. N.D. Ga. 1980).

[9] See *In re Stollenwerck*, *supra* (out of excess disposable income of $400 per month, plan proposed to pay $200 per month; no payments to unsecured creditors).

[10] See *In re Raburn*, 4 B.R. 624 (Bk. M.D. Ga. 1980).

Chapter 13 relief is essentially equitable, and contemplates a substantial effort by the debtor to pay his debts. Such an effort, by definition, may require some sacrifices by the debtor, and some alteration in prepetition consumption levels. Thus, the debtor might reasonably be required to devote to the plan that portion of his income which is not necessary for support of the debtor and his family. The courts may be expected to determine norms for such support, and Labor Department cost of living figures may provide some help. This approach will also permit plans to be confirmed where the debtor does make a substantial effort to pay his debts, even though the payment itself is not substantial.

B. Grain Storage Facility Amendments

This subtitle is designed to respond to the concerns and needs of the farm producing community with respect to farm produce storage facility bankruptcies, as those concerns and needs were expressed during hearings held on April 6th and May 18th, 1981. These hearings were prompted by the circumstances surrounding the bankruptcy of three farm produce storage companies which owned and operated thirteen crop storage facilities in the states of Missouri and Arkansas. Testimony of Mr. Thomas Hopkins, Coordinator of the Grain Regulatory Services Program of the Missouri Department of Agriculture, before the Subcommittee reflected that these elevator companies (commonly owned by three brothers, d/b/a Frisbee Cotton Company, James Gin and Elevator Company, and James Agri-Center, Inc., and hereinafter referred to as the James Brothers Elevators), filed voluntary petitions in bankruptcy in the United States Bankruptcy Court for the Eastern District of Arkansas on August 11, 1980. Two of these companies applied for liquidation under Chapter 7 of Title 11; the third (James Agri-Center) filed for reorganization under Chapter 11 of that title.

Mr. Hopkins related that immediately prior to the filings in bankruptcy, the James Brothers had, on August 8, 1980, notified the Missouri Department of Agriculture that all their legal entities were unable to comply with the requirements of the Missouri Grain Warehouse Law and that they wished to voluntarily surrender possession of the five Missouri warehouses to the Department. Employees of the Missouri Department of Agriculture then proceeded to secure and take possession of the five elevators and control over the grain stored in the five Missouri warehouses was given to the Director of Agriculture. This control was delivered in express recognition of the Director's statutory authority to take possession of crops on hand at an insolvent elevator for the purpose of enforcing the Missouri Grain Warehouse Law. An audit was conducted by the Missouri authorities which showed that, except for approximately 4,000 hundredweight of grain sorghum (milo) having a value of approximately $20,000, there was enough grain on hand at each of these warehouses to meet their obligations under the outstanding receipts held by the farmer-depositors, bankers, and Commodity Credit Corporation. On August 12, 1980, the state of Missouri acted to enforce the Missouri Grain Laws to insure delivery of stored grain to warehouse receipt holders, as rightful owners, by filing separate receiverships in the Circuit Courts of

New Madrid County, Dunklin County, Pemiscot County, Ripley County, and Butler County, state of Missouri. By orders dated August 12, 1980, the Director of the Missouri Department of Agriculture was appointed receiver of each of the Debtors' warehouses by those Circuit Courts of Missouri in accordance with the authority set forth in Section 411.519.6 of the Missouri Grain Warehouse Law.

Within a short time of the filings in bankruptcy on August 11, 1981, the Arkansas bankruptcy court appointed an interim trustee for the partnership debtors. The bankruptcy trustee obtained an order dated August 27, 1980, from the bankruptcy court authorizing him to operate the business of the partnership debtors, which included the right on his part to perform grain purchase agreements that the debtors had made with farmers. Upon request, he was also given the right to resell the grain so purchased to other parties pursuant to certain contracts of purchase and sale, which involved large quantities of grain. The trustee's plan, of course, became known to the public, and the farmer-receipt holders became incensed when, although grain would be leaving the warehouses to enable the trustee to perform these purchase and sale contracts, the farmer-depositors were told they could not get possession of the grain they had stored at these elevators, and to which they had retained title. Some of the farmer-sellers were even being required to sell additional grain to the trustee, who refused to release their stored grain. Because of their inability to take possession of their own property, the farmer-depositors took possession of, and barricaded others from entering, the Ristine, Missouri, grain warehouse administered by the bankruptcy trustee. The bankruptcy trustee responded with a motion to the court for orders finding the farmers in contempt of court, which asserted that these Missouri farmer-depositors were guilty of unlawful possession, criminal trespass, and blockade.

On September 17, 1980, the bankruptcy court granted an order directing the United States Marshal for the Eastern District of Arkansas and the United States Marshal for the Eastern District of Missouri to remove all persons blockading the facilities and directing that the marshals arrest and bring before the bankruptcy court any persons found to be blockading or barricading the James Brothers facilities or interfering with the trustee's "capacity to operate the debtor's business." United States Marshals appeared at the premises in force. In response to demands of the trustee in bankruptcy, the Missouri Receiver involuntarily surrendered possession, and, on September 17, 1980, the Missouri Department of Agriculture's employees turned over the keys to the bankruptcy trustee, his employees and agents. The Missouri Department of Agriculture's employees surrendered to the trustee only because they were threatend with contempt.

On September 23, 1980, the bankruptcy trustee filed a pleading in the Bankrupcty Court in which the trustee alleged that the grain in the four Missouri warehouses of the partnership Debtors, namely those at Holcomb, Caruthersville, New Madrid (Ristine), and Naylor, Missouri, was owned by him as trustee in bankruptcy, subject to the possibility of certain adverse claims. This was the first time that the trustee had made claim to ownership, and natu-

rally, state of Missouri officials became greatly disturbed at the time it was made because the trustee's claim to ownership was, in their view, inconsistent with the provisions of the Missouri Grain Laws (the trustee admittedly did not hold any document of title to the grain). After consideration by the Missouri Attorney General and the Missouri Department of Agriculture of the options available to the state of Missouri to preserve the integrity of its Grain Laws, the state of Missouri filed enforcement proceedings in the Circuit Court of New Madrid County, Missouri, on October 20, 1980. After an ex parte hearing, that Circuit Court issued a temporary restraining order prohibiting the bankruptcy trustee from exercising any jurisdiction with respect to the grain located in Missouri. Immediately thereafter, the legal representatives of the Missouri Department of Agriculture were advised that contempt proceedings against the Circuit Court would be held in the Bankruptcy Court on October 22, 1980. On October 30, 1980, the state of Missouri filed a Petition for Writ of Prohibition in the District Court in Arkansas and, on December 2, 1980, that Court decided the Bankruptcy Court had jurisdiction with respect to the grain located in Missouri. In its opinion, the District Court stated that it presumed the grain would not be sold until the ownership issues were determined. However, on December 4, 1980, the bankruptcy trustee requested the Bankruptcy Court to sell the grain without determining ownership, and the court so ordered. The December 4, 1980, decision obviously affected all of the holders of documents of title to the Missouri grain. Consequently, the state of Missouri requested a stay pending appeal in order that the jurisdiction and ownership issues could be decided before important property rights of the holders of the documents of title could be prejudiced. On December 22, 1980, the District Court denied the Motion for Stay Pending Appeal; later that day, the state of Missouri filed a Petition for Writ of Prohibition in the Eighth Circuit and obtained a stay of the bankruptcy proceedings. The appeal of these matters was set for hearing before the United States Court of Appeals for the Eighth Circuit in March of 1981, and decision was rendered on April 8, 1981, nine months after the filing in bankruptcy.

That decison held, in effect, that the bankruptcy court properly exercised preliminary jurisdiction over crop assets in which the debtor held a possessory interest, subject to final determination of ownership interests, as between holders of warehouse receipts (documents of title) and scale tickets (receipts) obtained from the debtor as documentary evidences of ownership of crop assets delivered to the debtor upon contracts of bailment, on the one hand, and the debtor and the debtor's assignees, on the other. (*In Re State of Missouri, et al.* v. *United States Bankruptcy Court for the Eastern District of Arkansas*, Nos. 80–2198 and 80–2179 [8th Circ., 1981].)

Farm producer-depositors became increasingly impatient during the litigation process described above, and on February 16, 1981, one producer forcibly removed approximately 33,000 bushels of soybeans from the Ristine, Missouri elevator under jurisdiction of the Bankruptcy Court, which he owned and had deposited therewith. This was done in violation of orders of the Bankruptcy Court and with the assistance and support of several hundred farmers. The

soybeans removed were taken to a nearby elevator and redeposited. As a result of this action, that producer was arraigned on federal charges relating to these acts in early March of 1981. The charges were subsequently dropped by a federal grand jury on March 20, 1981.

According to the testimony of Mr. Hopkins, the resolution of the James Brothers case is further complicated by the claims of entitlement to crop assets made by certain creditors holding secured interests as good faith purchasers for value of bogus warehouse receipts issued by the debtors purporting to assign title to crop assets owned by the debtors which did not in fact exist at the time the assignments were made.

The events in the James Brothers case were symptomatic of similar problems experienced by farm producer groups and state Department of Agriculture officials in farm produce storage facility bankruptcies throughout the United States during the past several years. Testimony before the Subcommittee on the Courts established that the following problems, encountered in the James Brothers cases, have repeatedly hindered the proper distribution of farm produce located in storage facilities that are the subject of proceedings in bankruptcy;

(1) delay in abandonment of crop assets owned by parties who have delivered such assets to the debtor upon a contract of bailment, with delays in excess of two years not uncommon;

(2) conflicts in jurisdiction between the bankruptcy courts and state agencies charged with the responsibility of supervising the liquidation of insolvent storage facilites;

(3) the requirements of present law which mandate that owners of crop assets held by the debtor solely on the basis of his status as a bailee must share grain assets held by the trustee in bankruptcy on a pro rata basis with any creditor holding a security interest in assets of a similar type which are owned by the debtor, such that the bailors of such storage contract crop assets have the value of their property diminished for the benefit of such creditors when there is a shortage of produce on hand;

(4) the unprotected status, as unsecured creditors in bankruptcy, of farmers who have sold crops to a farm produce storage facility but have not received payment for that crop;

(5) the reluctance of some courts to accept warehouse receipts and scale tickets, the principle documents used in warehouse business to establish record of ownership of crop assets stored in warehouse facilities on bailment contracts, as evidence of ownership in bankruptcy abandonment proceedings; and

(6) the tendency of certain bankruptcy courts to attach bailed property for the payment of trustees fees and expenses incurred in performing services unrelated to that bailed property.

The Subcommittee on the Courts received testimony from officials of the United States Department of Agriculture, state warehouse regulatory and licensing agencies, farm producer organizations, the National Grain and Feed Association, and representatives of various banking associations which detailed the occurrence

of these problems in warehouse bankruptcies in twenty-two states of the midwest and southeastern areas of the United States during the past two years.

In response to this testimony, the provisions of subtitle "B" of the Committee bill would do the following:

(1) The bill would require bankruptcy courts, upon request in a case involving a grain storage facility, to establish a timetable for the performance of all judicial and administrative functions in connection with the abandonment or other distribution of grain assets from such a facility;

(2) The bill would require the court to distribute grain assets or the proceeds of such assets first to producers who have merely stored their grain in such a facility upon a contract of bailment;

(3) The bill mandates distribution of grain within 120 days of the filing in bankruptcy except in cases involving special circumstances requiring more time;

(4) The bill contains measures requiring the court to allow state or federal agencies charged with the responsibility of liquidating farm produce storage facilities to participate in the distribution process;

(5) The bill contains measures which would strengthen present provisions of the Code allowing a right of reclamation to producers who have sold goods to a debtor in bankruptcy who have not received payment;

(6) The bill contains measures requiring the bankruptcy court to accept valid warehouse receipts and scale tickets as proof of ownership of crop assets posessed by the debtor upon contracts of bailment where they were issued for that purpose;

(7) The bill incorporates measures which would act to prohibit an involuntary bailment of crop assets owned by producers to a farm produce storage facility which is the subject of reorganization proceedings under Chapter 11 of the Bankruptcy Act; and

(8) The bill grants farm producers a priority position in the distribution of assets of the bankrupt to general unsecured creditors when those farm producers have suffered a loss as a result of the sale or conversion of farm produce to or by a debtor operating a storage facility, after trustee and court expenses, wages of employees, and pension plan payments.

The bill contains additional sections designed to inhibit frivolous appeals of abandonment orders, eliminate the possibility of grain assets being assessed for trustee fees and costs unrelated to the costs of preserving or distributing those assets, and certain definitional and technical amendments.

C. Leasehold Management Amendments

This section of the report will explain pertinent aspects of the U.S. shopping center industry and how the 1978 Reform Act and Subtitle C of the Committee bill apply to this essential industry. Shopping centers are made up of many commercial enterprises, a few large but most small. The success of these businesses is dependent upon the success of the centers as a whole and upon the suc-

cessful operation of the agreements entered into by the shopping center tenants and landlord to insure that all the parties cooperate for their mutual benefits.

In the 1978 Act, Congress enacted Section 365 of the Bankruptcy Code. The legislative history and the text of his provision make indisputably clear that Congress recognized and sought to deal with the potential harm to shopping centers and their solvent tenants which arises when one tenant becomes bankrupt and, therefore, is entitled (or his trustee is entitled) to assume or assign his lease. In effect, Congress recognized that shopping center tenants are inextricably tied together. When one suffers financial failure, neighboring tenants may be placed in jeopardy as well if the Bankruptcy Code does not provide an efficient arrangement to fill the vacancy.

Prior to the enactment of the Code, the interests of the nonbankrupt tenants and the landlord were protected by the contractual power of the lessor to terminate the lease in the case of a tenant bankruptcy. When Congress eliminated this power in the 1978 Act, it sought to establish other protections. Unfortunately, these protections have not carried out the Congressional intent. As a result, in the years since the enactment of the 1978 Act, it has become possible for the trustee in bankruptcy, or the bankrupt himself:

(1) To fail to decide whether he wishes to assume or reject the lease for an extended period of time, and to leave the premises unused or partially unused to the detriment of the surrounding businesses and the landlord;

(2) To fail to perform his obligations under the lease when due, including the payment of rent and other charges; and

(3) To fail to assign his lease, when he does assign it, to an assignee who will use the premises as the lease requires.

When any one or more of these three situations occur, the economic health of the entire shopping center is threatened. S. 445 strengthens the protections in the 1978 Act against these three situations to make their occurrence less likely and deals with other more technical problems with the 1978 Act.

(1) THE BANKRUPTCY REFORM ACT OF 1978

Prior to the enactment of the Code, the bankruptcy law was contained in "the Bankruptcy Act."[1] Under the Bankruptcy Act, in the case of the bankruptcy of a tenant, a shopping center was generally able to protect its interests and the interests of its other tenants by enforcing lease clauses permitting the lessor to regain control of the leased space. These lease clauses typically provided that if insolvency proceedings were initiated, the lessor could: (1) terminate the lease; (2) change the lease to a month-to-month tenancy; (3) waive or terminate an option to renew the lease; or (4) terminate the lease if the debtor was unable to maintain a certain sales volume or net worth.

Although some judicial decisions raised questions regarding the enforceability of such contractual agreements, these provisions usually enabled shopping centers to avoid damaging vacancies caused by the insolvency of a tenant.

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[1] The Bankruptcy Statute of 1898, Ch. 541, 30 Stat. 544 (1898), as amended.

(2) SECTION 365 OF THE BANKRUPTCY CODE: LANGUAGE, STRUCTURE AND LEGISLATIVE HISTORY

Section 365 of the Bankruptcy Code relates to executory contracts and unexpired leases. Subsections (a), (b)(1), (b)(3), (d)(1), (d)(2), (e)(1), (f)(1) and (f)(2) are of primary importance regarding unexpired shopping center leases. These sections provide as follows:

"(a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

"(b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee—

"(A) cures, or provides adequate assurance that the trustee will promptly cure, such default;

"(B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and

"(C) provides adequate assurance of future performance under such contract or lease.

* * * * * * *

"(b)(3) For the purposes of paragraph (1) of this section, adequate assurance of future performance of a lease of real property in a shopping center includes adequate assurance—

"(A) of the source of rent and other consideration due under such lease;

"(B) that any percentage rent due under such lease will not decline substantially;

"(C) that assumption or assignment of such lease will not breach substantially any provision, such as a radius, location, use, or exclusivity provision, in any other lease, financing agreement, or master agreement relating to such shopping center; and

"(D) that assumption or assignment of such lease will not disrupt substantially any tenant mix or balance in such shopping center.

* * * * * * *

"(d)(1) In a case under chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected.

"(d)(2) In a case under chapter 9, 11, or 13 of this title, the trustee may assume or reject an executory contract or unexpired lease of the debtor at any time before the confirmation of a plan, but the court, on request of any party to such contract or lease, may order the trustee to determine within a specified period of time whether to assume or reject such contract or lease.

"(e)(1) Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on—

"(A) the insolvency or financial condition of the debtor at any time before the closing of the case;

"(B) the commencement of a case under this title; or

"(C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

* * * * * * *

"(f)(1) Except as provided in subsection (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection.

"(f)(2) The trustee may assign an executory contract or unexpired lease of the debtor only if—

"(A) the trustee assumes such contract or lease in accordance with the provisions of this section; and

"(B) adequate assurance of future performance by the assignee of such contract or lease is provided, whether or not there has been a default in such contract or lease."

(Subsection (e)(1) makes termination clauses unenforceable. Subsections (b)(1) and (f) permit the trustee to assume or assign an unexpired lease subject to other provisions of this section. Subsection (b)(1)(C) and (f)(2)(B) require adequate assurances of future performance in the case of the assumption or assignment, respectively, of an unexpired lease. Subsection (b)(3) makes explicit what specific assurances of future performance are required in the case of a shopping center lease.)

By these provisions, a trustee's option to assume an unexpired shopping center lease after the lessee's default is limited not only by the general provisions of subsection (b)(1), but also by the specific "shopping center" provisions of subsection (b)(3). The purpose of these provisions is to ensure that an unexpired shopping center lease is assumed by the trustee only if the trustee provides adequate assurance of future adherence to the lease. The Code requires that performance to include assurances of the source of rent, assurances that percentage rents would not decline substantially (because of reduced sales), assurances that the use provisions contained in any other lease, financing agreement or master agreement would not be substantially breached, and assurances that the tenant mix would not be substantially disrupted.

Congress clearly intended to provide special protections for shopping centers and their solvent tenants when a trustee elects to assume an unexpired lease. Congress acknowledged the unique interrelationships of shopping center tenants and the potential ripple effect of a tenant bankruptcy on a shopping center and its solvent

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tenants by making shopping centers are the only kind of property protected with specific provisions of the 1978 Act, section 365(b)(3). An examination of the legislative history of these provisions explains and provides further support for the proposition that Congress intended to prevent shopping centers and their solvent tenants from being unnecessarily injured in the event that one tenant became insolvent.

As introduced, section 365(b)(1) and (f)(2) of H.R. 8200 required that "adequate assurances" of future performance be provided the lessor in the case of either an assumption or assignment by a trustee of an unexpired lease. The shopping center industry argued that this requirement was too vague to solve effectively the problems which would be encountered by shopping centers in the event of the assumption or assignment of a lease.

The House Judiciary Committee responded to these arguments by including the following language in its report:

> The unenforceability of ipso facto or bankruptcy clauses proposed under this section will require the courts to be sensitive to the rights of the nondebtor party to executory contracts and unexpired leases. If the trustee is to assume a contract or lease, the courts will have to insure that the trustee's performance under the contract or lease gives the other contracting party the full benefit of his bargain. An example of the complexity that may arise in these situations and the need for a determination of all aspects of a particular executory contract or unexpired lease is the shopping center lease under which the debtor is a tenant in a shopping center.
>
> A shopping center is often a carefully planned enterprise, and though it consists of numerous individual tenants, the center is planned as a single unit, often subject to a master lease or financing agreement. Under these agreements, the tenant mix in a shopping center may be as important to the lessor as the actual promised rental payments, because certain mixes will attract higher patronage of the stores in the center, and thus a higher rental for the landlord from those stores that are subject to a percentage of gross receipts rental agreement. Thus, in order to assure a landlord of his bargained for exchange, the court would have to consider such factors as the nature of the business to be conducted by the trustee or his assignee, whether that business complies with the requirements of any master agreement, whether the kind of business proposed will generate gross sales in an amount such that the percentage rent specified in the lease is substantially the same as what would have been provided by the debtor, and whether the business proposed to be conducted would result in a breach of other clauses in master agreements relating, for example, to tenant mix and location.

H.R. Report No. 595, 95th Congress, 1st Session, 348–349 (1977).

The Senate Judiciary Committee also responded to these concerns by incorporating the following in S. 2266:

* * * * * * *

"(b)(3) The provisions of paragraph (1) of this subsection shall not prevent termination of a lease pursuant to provisions contained therein—

"(A) in a case under chapter 7 of this title;

"(B) where the lease was entered into before the effective date of this title;

"(C) where the property leased thereunder is not essential to the debtor's business;

"(D) where the rent payable pursuant to the lease is substantially less than the fair rental value of the property leased thereunder; or

"(E) where the lease contains provisions for rent contingent upon the lessee's profits or sales and the rent otherwise set forth in the lease was substantially less than the fair rental value of the property at the time the lease was entered into.

* * * * * * *

"(b)(5) For purposes of this subsection, "adequate assurance" shall include with regard to an unexpired lease of the debtor reasonable assurance—

"(A) of the source of rental payments and other consideration due and owing to the landlord under the lease agreement;

"(B) that there will be no substantial decline in any percentage rates specified by the lease;

"(C) that the assignment or assumption of the lease will not substantially breach clauses (including, but not limited to, radius, location, use, and exclusive clauses) in other leases, financing agreements, or a master agreement relating to the leased and adjoining leased premises; and

"(D) that an assumption or assignment of a lease will not disrupt the tenant mix or balance in property subject to multiple individual leases and an overall master agreement."

Further, the Senate Committee made clear in its Report that subsection (b)(5) was intended to assist shopping centers:

> Subsection (b)(5) provides that in lease situations common to shopping centers, protections must be provided for the lessor if the trustee assumes the lease, including protection against decline in percentage rents, breach of agreements with other tenants, and preservation of the tenant mix. Protection for tenant mix will not be required in the office building situation.

S. Report No. 989, 95th Congress, 2d Session, 59 (1978).

By agreement of the Senate and House floor managers of this legislation, a compromise bill was introduced which contained the language in subsection (b)(3) and which was ultimately enacted.

In the Senate and House debates on the compromise bill, this provision was described as follows:

> Section 365(b)(3) represents a compromise between H.R. 8200 as passed by the House and the Senate amendment. The provision adopts standards contained in section 365(b)(5) of the Senate amendment to define adequate as-

surance of future performance of a lease of real property in a shopping center.

124 Cong. Rec. S 17409 (daily ed., Oct. 6, 1978) (remarks of Sen. DeConcini); 124 Cong. Rec. II 11093 (daily ed., Sept. 28, 1978) (remarks of Mr. Edwards).

(3) LEGISLATIVE HISTORY: THE SHOPPING CENTER PROTECTIONS IMPROVEMENTS ACT OF 1982, S. 2297

In March 1982, the Shopping Center Protections Improvements Act of 1982, S. 2297, was introduced by Senators Hatch and DeConcini and was subsequently co-sponsored by Senators East and Baucus of the Senate Subcommittee on Courts and by several other members of the Judiciary Committee. The bill was strongly supported by the shopping center industry. Individual shopping center landlords, and tenants and the trade associations representing shopping center landlords, tenants, and financiers testified in support of the bill.

Hearings were held in Washington, D.C. on May 3, 1982.

S. 2297 was unanimously voted out of the Subcommittee on Courts on May 21, 1982, with an amendment in the nature of a substitute offered by Chairman Dole accepted thereto.

On August 4, 1982, with a quorum present, the full Judiciary Committee by voice vote ordered the bill favorably reported having previously agreed to five amendments.

On October 1, 1982, S. 2297 was unanimously passed by the Senate. Subtitle C of this legislation is identical to S. 2297 as passed by the Senate, with the exception of technical amendments, which exempt residential leases from the provisions of this subtitle.

(4) BACKGROUND AND NEED FOR LEGISLATION

The Bankruptcy Code, enacted by the Bankruptcy Reform Act of 1978, was the first major revision of the bankruptcy laws of the United States since 1938, and its enactment was the culmination of an effort that extended over a number of years. The Code made numerous substantive changes in the law of bankruptcy as well as in the administration of bankruptcy cases.

One of these changes made unenforceable lease clauses permitting a landlord to regain possession of premises leased to a bankrupt tenant. However, Congress recognized the unique interrelationship between shopping center tenants and the great potential for harm to shopping centers and their solvent tenants arising from the ability of a bankrupt tenant to assume or assign a shopping center lease. To protect this important sector of the economy from unnecessary economic harm, Congress enacted in section 365 of the Code certain protective provisions for shopping centers and their tenants. Unfortunately, these provisions have not accomplished these purposes. As a result, this Committee has reported S. 2297 to carry out Congress' intent as stated in the 1978 Act and to strengthen the protections for shopping centers under the Bankruptcy Code.

(5) SHOPPING CENTERS ARE UNIQUE REAL ESTATE ARRANGEMENTS WHICH SUBSTANTIALLY BENEFIT THE ECONOMY

Shopping centers are an important sector of U.S. retail trade. In 1981, in the U.S. there were approximately 22,750 shopping centers with an estimated 1,255,000 retail stores. Approximately 42 percent of all U.S. retail trade amounting to $439 billion was conducted in shopping centers. In the coming year, 60 percent of all new retail space and 88 percent of new department store space is likely to be constructed in shopping centers.

The problems for shopping centers and their tenants caused by the present administration of the Code are serious and widespread. Conservatively estimated, 15,000 shopping centers have had one or more tenants involved in bankruptcies in 1981. Under this estimate, approximately 65 percent of all shopping centers were involved with the bankruptcies of 17,000 retail stores.

In a shopping center, the public benefits from the convenience and efficiency of "one-stop" shopping and frequently from the direct competition among the retail merchants who are tenants of the shopping center. The commercial success of the enterprise depends on the ability of all of the tenants to function as one entity. The shopping center is defined by its "tenant mix" which is carefully designed to serve a "trade area" and to draw sufficient customers from that trade area to support the rents paid by the tenants.

To make this enterprise work, each tenant must fully operate its store for a minimum of hours, engage in specified lines of business, advertise in ways that draw customers to the shopping center, and maintain certain standards of appearance and operation. This joint effort is cemented by a series of master agreements, entered into by all the parties involved in a shopping center, that set forth in precise terms the rights and obligations of each party.

As shopping centers have evolved, they have become larger and more sophisticated in design, construction and concept, involving tens of millions of dollars of investments by developers, tenants, and financial institutions. Once again, the linchpin of this entire operation is the freely accepted and openly negotiated contractual agreements among the parties.

While the operation of the bankruptcy law necessarily alters contractual relationships, these alterations have direct and potentially crippling impacts on other shopping center businesses, and consequently, must be strictly limited and minimized. Accordingly, the Committee have favorably reported S. 2297.

(6) SHOPPING CENTER TENANTS AND THEIR LEASES ARE UNIQUE IN THEIR INTERDEPENDENCE

As Congress recognized in enacting the 1978 Act, shopping center leases are distinct from other leases of real property in that each lease arrangement memorializes not only the bilateral interests of the tenant and the landlord, but the multilateral relationships of every other tenant in the shopping center. The interdependence among the tenants of a shopping center means that the bankruptcy of one tenant will seriously affect the other tenants.

Shopping center leases frequently are made on a long-term basis in consideration of the large investment usually made by tenants in establishing their various enterprises. These long-term lease agreements put the landlord into a position unlike a merchandise creditor or a financial institution lender. A shopping center landlord, unlike other creditors, cannot make periodic reviews of the financial condition of his customers and unilaterally terminate creditor loans whenever it appears that the customer's credit is impaired. These long-term contracts obligate both parties to honor their agreements to protect the delicate interrelationships which form the foundation for the shopping center's success.

Moreover, shopping center leases frequently contain "anchor" clauses which commit the tenant to a lease term only so long as another designated tenant remains in the shopping center. These provisions further manifest the symbiotic, interdependent nature of a shopping center.

Mr. Nathan B. Feinstein testifying before the Courts Subcommittee in 1982, capsulized this principle beautifully:

> Tenants locate in shopping centers based on the complementary ability of the various stores in the shopping center to draw customers. One looks to the advertising and the merchandising techniques of the larger stores (anchor stores) in choosing a shopping center. One considers carefully the cooperative advertising, the center promotions, and the parking and other common services. The shopping center and its tenant's association rely on a continuing stream of payments from tenant-shopkeepers to meet the snow removal, air conditioning, heating, parking lot maintenance, advertising, mortgage, tax and other obligations of the center. When the stream of payments is disrupted for a significant period of time, every shopowner suffers by the lack of maintenance and uncertain financial viability of the center. When an anchor store closes its doors and stops advertisements, the smaller stores suffer the lack of patronage. When Saks Fifth Avenue moves out as anchor store and John's Bargains moves in, the small independent fashion boutiques die. When the future of the center is in doubt, the businessman-tenant does not know how to order for the season.

These multifarious symbiotic relationships in the shopping center are in peril whenever any tenant suffers financial hardship or fails. The continued vitality of those relationships and the businesses in the center depends on the system our bankruptcy policies create to swiftly fill vacancies and fairly acknowledge the interests of remaining solvent tenants. Hearings on S. 2297 before the Subcommittee on Courts of the Senate Judiciary Committee, 97th Cong. 2d Sess. (1982) (hereinafter "Hearings").

(7) PROTECTION OF SOLVENT SHOPPING CENTER TENANTS IN THE EVENT OF THE BANKRUPTCY OF A TENANT

Prior to the enactment of the 1978 Act, the interests of the shopping center and its other tenants were protected against prolonged

damage from a single tenant's bankruptcy by the contractual power of the lessor to control the disposition of the lease. As stated earlier, however, the 1978 Act made such lease clauses unenforceable. Nevertheless, Congress recognized the special bankruptcy problems in shopping centers by including in the Code special provisions governing unexpired shopping center leases. These provisions specify various assurances which the trustee must make in order to assure or assign an unexpired lease of the debtor.

Unfortunately, experience with these provisons indicates that they have not functioned as originally intended by Congress. Under the Bankruptcy Code, the shopping center and its solvent tenants may suffer serious economic harm or even business failure if a bankruptcy tenant cloes its store for an extended period of time or assigns its lease to a business which does not conform to the lease's use clause thus disrupting the shopping center's tenant mix. These problems are compounded when the bankrupt tenant is a major store in the shopping center.

Subtitle C seeks to make effective the protections that Congress intended to provide shopping centers and their tenants in the 1978 Act. It accomplishes this by removing latent defects in certain provisions of the Bankruptcy Code. These perfecting amendments do not change the policy of the Code; they implement that policy. By making effective these protections, the bill strikes the proper balance between the interests of the solvent tenants of a shopping center and its insolvent tenants.

(8) PROBLEMS AND SOLUTIONS

At the May 3, 1982, hearing on this bill, testimony in support of S. 2297 was received from the International Council of Shopping Centers—the trade association of the shopping center industry—from individual shopping center developers, and from the President of the Frederick Maryland Shopping Center Merchants Association, a shopping center which had experienced tenant bankruptices. In addition, a statement supporting the bill was submitted for the record by the National Retail Merchants Association, which represents the small business tenants of shopping centers. Hearings, supra.

At the January 24, 1983 hearing on this legislation, testimony in support or subtitle C on this bill was received from the International Council of Shopping Centers and the President of the Frederick Shopping Centers Merchants' Association.

Shopping centers and shopping center tenants support this legislation because the administration of bankruptcies under the Code has resulted in numerous cases where shopping center tenant space was left closed for an extended period of time, where the trustee did not perform the debtor's obligations under the lease, or where shopping center space was assigned to a business not in conformance with the use clause.

The purpose of the bill is to remedy several substantive and technical problems relating to the operation and assignment of shopping center tenant space which have arisen under the Code. As the technical amendments to this section of the bill make clear, the so-

lutions in this bill are not intended to apply to residential leases. These problems and the bill's solutions to them are as follows.

a. Time limit to assume or reject lease

i. *Problem.*—Under the 1978 Act, in a Chapter 7 (liquidation) case the trustee is required to decide within 60 days of the order for relief whether to assume or reject an executory contract or unexpired lease. However, no time limit is established for cases outside Chapter 7. Consequently, an extended period of time often passes before the trustee makes such a decision in a Chapter 11 (reorganization) case. During this dead time, the trustee often does not operate the space, or operates it at a much reduced level, thereby causing substantial economic harm to other tenants in the shopping center.

The testimony of witnesses representing shopping centers and shopping center tenants at the hearings and the 1982 statement for the record of the National Retail Merchants Association (NRMA) makes clear that this is one of the major problems of shopping centers and their tenants caused by the administration of tenant bankruptcies under the Code.

The vacancy of any tenant space for an extended period of time can seriously disrupt an entire shopping center. Customer traffic is reduced not only by the decreased supply of products or services, but also by the less pleasant atmosphere caused by boarding up a portion of the shopping center. Where the vacant space is that of an anchor store, the effect on the shopping center and its other tenants can be devastating.

For example, in 1982, Mr. John Holmes, President of a shopping center merchant's association in Frederick, Maryland, testified "to explain the damage to the other tenants of the Frederick Shopping Center resulting from the closing of these stores and the inability of the shopping center to release this space to operating businesses for a period of time." He then recounted that one store in the Frederick center was vacant for over nine months and another for nearly five months. He noted that: "I have difficulty understanding how other tenants . . . survived. Even the comparably short time [the bankrupt stores were closed] severely damaged the business of many of the merchants of this shopping center, and in many cases the stores have not yet recovered." Hearings, supra. He pointed out that some neighboring stores suffered 28 and 26 percent reductions in sales volume during the period the bankrupt's premises were vacant.

In his testimony in 1983, Mr. Holmes contrasted the difficulties the shopping center encountered in 1981 and 1982, caused by the closing of a failed store in a bankruptcy proceeding, with the lack of harm to the other tenants when a Woolco store closed in early 1983, but was not involved in a bankruptcy proceeding.

The shopping center landlord is injured in these circumstances because in many cases shopping center leases provide for rent as a percentage of revenues. These clauses are beneficial because they provide the landlord a financial incentive to preserve the most productive tenant mix. However, these clauses are often based on the calculation that tenant businesses will be in full operation. When a

store is closed, or operated at a reduced capacity, the shopping center landlord's revenues also decline.

Detailed testimony was recieved from shopping center tenants regarding the serious problems to their businesses caused by the ability of the trustee to close a store in a shopping center for an extended period of time without stating his intention regarding the disposition of the premises, and preventing the landlord from releasing the space to an operating business. Mr. Wallace R. Woodbury of Salt Lake City, Utah, testified that a tenant in his shipping center had filed under Chapter 11 eight months previously, had still not submitted a reorganization plan, was not operating the premises and was not paying rent. One expert witness stated that it usually takes between nine months and a year to get a determination concerning the assumption or rejection of a lease in a contested Chapter 11 case.

During this time, the other tenants of a shopping center may be affected dramatically. The closing of even a single store in a shopping center may substantially reduce the revenues and increase the costs of the other tenants. Their revenues are reduced because the closing of a store in a shopping center, especially a major store, reduces the traffic flow through the shopping center.

The closing of a major tenant can also significantly increase the costs of the other tenants. In many shopping centers, common area charges are assessed each tenant on the basis of the tenant's percentage of total leased space. The closing of a major tenant substantially reduces the amount of total leased space. This increases the percentage of toal leased space of all the remaining tenants and their share of the common area charge.

Mr. Howard C. Oliver of Jim Wilson & Associates in Montgomery, Alabama, summarized the problem of delayed assumption as follows:

> [The law allows] open ended and often lengthy delays in the decision by the trustee of debtor-in-possession to assume or reject a shopping center lease. This often results in an extended period when a store is vacant, and this hurts the business of the other tenants and forces the shopping center and the other tenants to bear some of the costs of the bankruptcy. Hearings, supra.

ii. *Solution.*—The bill reduces the severity of these problems by imposing a 60 day time limit on the trustee's decision to assume or reject a non-residential lease in cases under any chapter of the Code, unless the court, for cause, allows additional time. This puts the burden of justifying an extension on the party best equipped to gauge the length of time necessary to make an assumption decision, the non-residential leaseholder.

A distinction between residential and non-residential leases is made here and in other provisions of this subtitle. The application of these provisions is limited to non-residential leases in order to avoid depriving residential tenants of whatever consumer protections they may have under applicable non-bankruptcy law.

In all but the most complicated reorganization cases 60 days should be a sufficient period to make this determination. Even in large reorganization cases, the debtor presumably knows his own

business and understands the value of his assets well enough to make such decisions in 60 days. Also, the debtor is generally well aware in advance that a bankruptcy may be necessary and can plan ahead to decide which leases should be retained. The debtor should consequently be able to make this determination shortly after the petition is filed and certainly within 60 days in all but the most complicated cases. Nonetheless, the court has authority to grant extensions for cause.

b. Failure to perform lease obligations, including the payment of rent and other charges when due

i. *Problem.*—During the time the trustee is deciding whether to assume or reject the lease, the trustee frequently does not meet the lease obligations, such as paying rent and other charges. As discussed above, the trustee's failure to pay common area charges often increase the costs of the shopping center's other tenants.

In addition, this situation often results in the landlord's providing current services—the use of his property, and the provision of utilities and security to protect and preserve the leased property—without current compensation, a burden imposed on no other class of creditor. This burden is particularly onerous where the landlord needs the rent payments provided in the lease in order to make tax or mortgage payments on the property.

In reference to this problem, Mr. Wallace Woodbury testified that:

> This presents a hardship to a landlord who may not receive a rent for several months and is unable to gain control of his premises. I am not aware of any other class of person who is required to provide a service to the bankrupt estate without current compensation. Hearings, supra.

ii. *Solution.*—The bill solves this problem by requiring the timely performance of the non-residential lease obligations, including the payment of rent and other charges. However, the bill permits the court to extend the time for performance of such payments to a date no later than 60 days after the order for relief. Such an extension could be granted where a trustee is unfamiliar with the operation of the debtor's business and there is no reason to question his legal duty to pay rent or other charges or perform other obligations under the lease.

c. Compliance with use clauses and other provisions of the lease

i. *Problem.*—The Code currently requires adequate assurances that the assumption or assignment of an unexpired lease will not breach "substantially" important provisions of shopping center leases (provisions such as "radius, location, use of exclusivity" clauses) and will not "substantially" disrupt the tenant mix. Congress thus intended to protect shopping centers and their solvent tenants from the consequences of the violation of use clauses and the disruption of the tenant mix. Also, it is clear that whatever the intended meaning of the term "substantially," it has been interpreted in a way which has frustrated the Congressional intent. While it may seem reasonable to permit the assignment of a

women's wear store lease to a men's wear store, such an assignment can be commercially unreasonable because the clientele attracted by such stores would be vastly different. Such an assignment could be extremely damaging to the other men's wear store tenants as well as the other tenants in the shopping center. This was the damage Congress sought to prevent through the enactment of section 365(b)(3) of the Code.

In practice, the qualification of the required assurances by the term "substantially" has led trustees or debtors-in-possession in some instances to ignore these lease clauses and, consequently, has permitted the disruption of the delicate interrelationships of the shopping center's tenant mix. In one case, the bankruptcy court permitted a tenant to change the use of its premises, a discotheque, to permit male striptease shows.[1] In another case, a bankrupt men's wear chain store assigned a number of leases to women's wear stores.[2] In another instance, advertisements for bids on shopping center space indicate that the term "substantially" permits gross deviations from the use clause. These advertisements, placed by lease brokers, state that "all retail uses" would considered even though the leases involved had more limited use clauses.

The assignment of a lease to a business that does not conform to the use clause of that lease, especially in the case of a major store lease, can affect the other tenants much in the same way as the closing of the store. Where the misassignment occurs in the case of the major store in a strip center, the effect can be disastrous, substantially reducing the revenues of all the other tenants. For example, the assignment of the lease of a grocery store, with substantial and steady drawing power, to a toy store, with less ability to attract customers, would reduce the traffic of all of the other shopping center tenants.

In a regional mall with more than one major tenant, the misassignment of that lease will have less effect on the entire mall, but stores adjacent to it may suffer considerable reductions in customers. For example, replacing a small store with substantial customer attraction power—such as a women's wear store—with another business which generates less traffic would have an adverse effect on the adjacent stores.

Adjacent stores also can be severely hurt through violations of the use clause when a complementary use is replaced with a competing use. Mr. Wallace Woodbury, for example, testified regarding space he had leased to a record and tape store situated next to a T.V. and consumer electronics store. Immediately after exercising a lease renewal option the tenant filed a bankruptcy petition and vacated the premises. Despite the fact that the landlord had a replacement tenant with substantial assets who complied with the use restriction of the lease, the Trustee assigned the lease to a financially unsound shell corporation which sold substantially the same type of merchandise as the adjacent T.V. store. On taking possession the assignee immediately advertised "going out of business prices." After suffering six months of unfair and ruinous competition from the assignee tenant the T.V. store vacated the prem-

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[1] *Reyco of Nevada* v. *Russel D. Johns*, 5 BCD 1074 (D. Nevada 1979).
[2] *In re Hughes & Hatcher, Inc.*, Case No. Bk. Ct. S.D.N.Y., No. 82B 101521 (JL).

ises on the grounds that the landlord's exclusive commitment to it had been violated. Seven months later and after failing to pay substantial rent, the assignee tenant itself went out of business and abandoned the premises. In the words of Mr. Woodbury, "the landlord ended up with vacancies in two stores, the substantial loss of rental income, and considerable building damage and the nonbankrupt tenant lost substantial sums and was forced to abandon the shopping center because of the trustee's utter disregard of the lease provisions which were designed to protect both the landlord and the non-bankrupt adjacent tenant." Hearings, supra.

Pre-existing stores also are disadvantaged if the rental payments of the assignee are lower than those of the pre-existing stores. Stores in the same line of business are usually charged equivalent rents based on their business use. Women's wear stores usually pay lower rents than other stores because they tend to draw more customers to the shopping center than do other types of stores. Thus, if the lease of a bankrupt women's wear tenant is assigned to a men's wear store, the assignee men's wear store may be paying less rent than will the pre-existing competing men's wear stores.

Also, the pre-existing men's wear stores may be harmed unfairly by the over-saturation of the men's wear market resulting from the assignment to an additional men's wear store. This deprives them of the benefit of their bargains with the developer which were based on an agreement on the number of men's wear stores to be included in the shopping center.

Senator Orrin G. Hatch, author of S. 2297, succinctly explained this situation in his statement to the Courts Subcommittee:

> In the event the lease is assumed by the administrator, it may be assigned to a business not in full compliance with the use limitations of the lease * * * For example, several men's shoe stores may have negotiated their leases with the shopping center understanding that all men's shoe stores would pay identical rent. Assigning a women's shoe store lease at a lower rent to another men's shoe store could both oversaturate the men's shoe store market and give the incoming store the unfair advantage of a lower overhead.

By disregarding a use clause in an assignment situation, the trustee is able to create and sell an asset (the lease) that did not previously exist. This asset is not created out of thin air; rather, it is unfairly created at the expense of the landlord and the other tenants of the shopping center.

In many cases where the assignment of shopping center leases is a significant asset of the estate of the debtor, the debtor is a large chain store enterprise. Such enterprises negotiate with shopping center developers over lease provisions vigorously and from a position of strength. Use clauses and other lease provisions favorable to the landlord and other tenants are accepted as part of the lease by these tenants only because of the granting by the landlord of concessions in other terms of the lease. In the words of Nathan B. Feinstein, "[Use clauses] are almost always carefully drawn and extensively negotiated. More important, they are relied upon by other tenants in the shopping center." Hearings, *supra*. Careful ad-

herence to the provisions in use clauses is necessary to give all enterprises in a shopping center the benefit of their respective bargains. More important, strict compliance with the use clauses is needed to ensure the other tenants that the center will be what they expected when they agreed to commit themselves and large amounts of capital to the center for a long period of time.

ii. *Solution.*—By deleting the word "substantially," the bill makes clear that important lease provisions such as the use clause are to be honored and that the tenant mix is not to be disrupted. Not all shopping center leases contain restrictive use clauses, but where they are included in a lease they are necessary to define the tenant's business in relation to the other stores in the shopping center. Restrictions on the assignability of shopping center leases are justified by the need to protect the interests of the other tenants in the shopping center.

This provision does not unduly restrict the assignment of shopping center leases. Use clauses cannot be overly restrictive because they must permit enough flexibility to allow for the normal conduct of the original tenant's business. Mr. George Lambros of Missoula, Montana, who devoted his entire testimony to the use limitation problem, explained:

> It is important to note that deleting the word "substantially" from these provisions would in no way prevent the assignment by debtors of their leases. Although shopping center lease use provisions are drawn with various degrees of specificity, even the narrowest use description still covers a market segment served by a very large number of existing and potential businesses. Although requiring strict performance of the use clause of the lease will limit the universe of potential assignees of any shopping center lease space, this limitation is absolutely necessary for the health of the shopping center and its other tenants and does not place an unreasonable burden on the debtor. Hearings supra.

Use clauses are not intended to prevent the assignment of leases and practice in the shopping center industry shows that they will be interpreted reasonably. Any attempt to preclude assignment by drafting a use clause which would apply only to the original tenant would be de facto prohibitions of assignment, and, therefore, would be unenforceable under section 365(f)(1).

Where the trustee is unable to find an assignee within the use clause who is willing to pay what the trustee considers an acceptable price for the lease, the Committee believes that it is appropriate for the lease to revert to the landlord.

Even where the landlord also is unable to find a replacement tenant with the same business use as the debtor, the Committee believes that it is preferable to have an alternate use determined by the landlord rather than by the trustee and the Bankruptcy Court. It is in the interest of the debtor to choose the assignee which will pay the highest amount for the lease and thus maximize the proceeds from the sale of the lease, regardless of the impact of the assignment on the other tenants. On the other hand, it is in the interest of the landlord to select an assignee who will have the most

beneficial effect on the business of the entire shopping center even though that assignee may not pay the highest rent. This is the case because shopping center landlords derive much of their income from percentage rents, i.e., rents based on a percentage of the sales of the tenants. Thus, they have a strong incentive to select a tenant that will enhance the tenant mix and, thereby, increase the sales of all the tenants of the shopping center.

d. Operating and financial performance of assignee

i. *Problem.*—If shopping center space is assigned to a business in poor financial condition, the shopping center and its solvent tenants may soon find themselves dealing with another store in bankruptcy, with all of the attendant problems. As discussed above, when the trustee assigns space to a store in unsound financial condition, the harm to the landlord and the other tenants is compounded.

ii. *Solution.*—Under the Code, adequate assurances of the source of rent and other consideration due under the lease must be given. The bill makes clear that this includes assurances that the assignee has an operating and financial performance similar to that of the debtor when the lease was first executed. This provision was amended by the full Judiciary Committee to ensure that it would not be interpreted to mean that the assignee must have exactly the same financial posture as the assignor. Instead, the assignee should have a similar operating and financial performance when all factors, including advertising aggressiveness, profit margins, growth potential, and other financial indicia, are weighed.

e. Payment of security deposit by assignee

i. *Problem.*—In some cases, the assignee of a lease is not required to pay the customary security deposit. Security deposits provide an incentive for a shopping center tenant to keep his space in good repair, a requirement which benefits the entire shopping center enterprise.

ii. *Solution.*—The bill provides that an assignee of a non-residential lease pay the same security deposit as would be required by the landlord, if the landlord was leasing the space.

(9) TECHNICAL AMENDMENTS

a. Compliance with provisions of the lease assumed

i. *Problem.*—Some trustees have interpreted the Code as providing that an assignee of a shopping center lease does not have to comply with the use and other important clauses contained in the lease being assumed, but only is bound to comply with such clauses contained in the other leases, financing agreements, and master agreements relating to the shopping center. Such an incorrect interpretation would allow an assignee to violate the use clause of the lease. This interpretation clearly is contrary to the intent of this Committee and works to the detriment of the shopping center and all of its solvent tenants.

ii. *Solution.*—The bill confirms that under the Code, the new tenant must comply with all the provisions of the lease being as-

sumed, as well as the provisions of other agreements relating to the shopping center.

b. Application of protections in all assignment situations

i. *Problem.*—Specific protections are provided for shopping centers and their tenants by the Code. However, due to a technical omission in the Code, these protections may be construed to apply only if there has been a default of the lease. This would permit a trustee to assign a lease in violation of these protections as long as he does not default on the lease.

ii. *Solution.*—The bill confirms that these protections apply to any assignment of a shopping center lease, whether or not there has been a default.

c. Termination under State law

i. *Problem.*—If a lease is terminated under state law prior to the order for relief, by reason of its own terms or by judicial order, there is a potential ambiguity about its inclusion in the estate.

ii. *Solution.*—The bill removes any possible ambiguity by clarifying that under existing law a non-residential lease is no longer property of the debtor and should not be subject to the bankruptcy proceedings.

d. Termination by its own terms

i. *Problem.*—Where a lease terminates by its own terms, i.e., where the term of the lease comes to an end at a date certain, potentially there is uncertainty as to whether any rights in the property become assets of the bankrupt's estate.

ii. *Solution.*—The bill makes it clear that in such a case a non-residential lease not the property of the estate, that the automatic stay provisions of the Code do not apply, and that the landlord can recover the premises as provided under state law.

D. Amendments Relating to the Discharge of Debts Incurred by Persons Driving While Intoxicated

Subtitle "D" of the Committee bill is a modified version of S. 2159 (97tn Congress), a bill introduced by Senator Danforth which would render debts incurred as a result of an act of drunk driving non-dischargeable in bankruptcy.

Under present law, a debt that is the result of a tortious act—such as a judgment against a debtor as the result of an automobile accident—is non-dischargeable only if the debt is the result of a "willful and malicious injury" to the property or person of another.

In most states, an injury resulting from an act of drunk driving will support a finding only of negligence on the part of the driver. Thus, more often than not, the debt is discharged—unless the bankruptcy court finds that the act of drunk driving was a willful and malicious act by the nature of the circumstances surrounding it.

The bill will help deter drunk driving, and protect victims of the drunk driver, by making such debts non-dischargeable in bankruptcy. Where a debt was incurred by the debtor as a result of an act of drunk driving, that debt will not be dischargeable regardless of any

court finding that willful, wanton, or reckless behaviour was or was not involved.

E. Referee's Salary and Expense Fund Amendments

The text of this subtitle is drawn from S. 863, passed unanimously by the Senate in 1981 and by the House as H.R. 4353 and 5116 during the 97th Congress. The legislation would remedy a drafting error in the 1978 Bankruptcy Reform Act.

Under the old Bankruptcy Act, trustees in liquidation and corporate reorganization cases had to pay a percentage of the estate assets into the referees salary and expense fund, the purpose of which was to offset the costs of operating the bankruptcy system. Since the fund never generated more than a small percentage of total bankruptcy operating costs, Congress in 1978 elected to abolish the fund, and place a cap on payments that would be required to be made to the fund by trustees in cases under the old Act.

The drafters of the 1978 Reform Act made two errors. First, they failed to insert a provision placing a cap on payments under the old Act in liquidation cases. And second, the cap limitation on payments in corporate reorganization cases under the old Act was made dependent upon the plan being confirmed in those cases after September 30, 1978—a date prior to the passage of the Reform Act. Unfortunately, there were a handful of corporate reorganization cases wherein plans had been confirmed prior to September 30, 1978, but the amount of the fund payment had not yet been determined at the time of the passage of the Reform Act.

The bill remedies these problems by placing a $200,000 cap on payments in liquidation cases filed under the old Act, and by extending the cap in reorganization cases under the old Act to cover those cases where plans were confirmed prior to court order fixing the precise amount payable to the fund was entered by the court subsequent to September 30, 1979.

F. Repurchase Agreements Amendments

(1) Introduction

Use of repurchase agreements (sometimes referred to herein as "repos")[1] has grown rapidly in recent years. Repos are now considered to be a principal means of financing the market for United States Government securities and money market instruments. Recently, however, a serious question has arisen whether the securities and commodities amendments to the Bankruptcy Code (the "Code"), enacted last year as Public Law 97-222, adequately cover the repo market. As a first step, the proposed amendments to the Code would address this question:

(a) by providing new definitions of "repo participant" and "repurchase agreement" in section 101, and

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[1] A repo represents a transfer of a financial instrument—often government securities—by one party to another party for payment, with a simultaneous agreement by the second party to retransfer securities to the first party on demand or on a date certain against payment which reflects a rate of interest. A reverse repo is the mirror image of a repo, generally initiated by the party originally transferring the securities.

(b) by creating a new section at the end of Chapter 5 and making conforming amendments to sections 362(b), 546, 548(d)(2) and 553(b)(1) of the Code to ensure there is no question that repo participants are afforded the same treatment with respect to the stay and avoidance provisions of the Code in connection with repurchase agreements, as newly defined, which Public Law 97-222 explicitly provided stockbrokers, securities clearing agencies, commodity brokers and forward contract merchants in connection with securities contracts, commodity contracts and forward contracts.

These amendments would take an important first step in resolving the recent uncertainty about whether the provisions of Public Law 97-222 adequately cover the repo market. This uncertainty largely stems from litigation in the *Lombard-Wall* case, as described below, and has introduced considerable confusion in the use of repo transactions in financial markets. The current Congressional review of other major problem areas in the Code presents an immediate opportunity to eliminate this confusion.

These amendments are offered as an emergency measure to deal with the effect of the present uncertainty on the repo market only in respect of U.S. Government and agency obligations, certificates of deposit, and eligible bankers' acceptances.

(2) DESCRIPTION OF THE REPO MARKET

As indicated above, repo transactions provide one of the major mechanisms for limited-term investment involving all U.S. Government and agency securities, mortgage-related instruments, commodities and all money market instruments (*e.g.*, certificates of deposit, bankers' acceptances and commercial paper).

The volume of repo transactions is very large. The 36 members of the Association of Primary Dealers in U.S. Government Securities (the "Primary Dealers") alone engage in repo transactions amounting to about $25 billion to $30 billion each day. It is difficult to determine the total size of the repo market, but one can safely estimate that the aggregate *daily* amount of repo transactions amounts to *several hundred billion dollars*. This should come as little surprise, since the financial assets that are the subject of repos include a substantial part of the approximately trillion dollar U.S. public debt.

The repo market serves a crucial function for both parties to the repo transaction. The country's major institutional and fiduciary investors make heavy use of repos. For these investors, including such entities as state and local governments, public and private pension funds, money market and other mutual funds, banks, thrift institutions, and large corporations, repos have become a vital tool of cash management.

The repo is particularly well-suited to the needs of these investors. Receipts of taxes and the proceeds of bond issues in the case of state and local governments, cash flows from corporate operations, and liquidity needs of thrift institutions and money market funds often fail to coincide with the planned expenditures of such funds, thereby creating the need for such entities to invest idle funds for short periods in as risk-free a manner as possible.

Repos generate income for the supplier of funds while at the same time providing flexibility, since they can be arranged for periods which match the supplier's cash flow needs, including periods as short as one day. Few, if any, other investment vehicles have this feature. Government securities or other financial assets can be bought and held for short periods other than in repo transactions, but the transaction costs can be relatively high. Moreoever, the possibility of capital loss due to market rate volatility or the risk of reinvestment at a lower rate of return significantly reduces the attractiveness of investment alternatives.

For the Primary Dealers in the government-related securities market, the repo market has become the principal means of financing their positions. Repos provide dealers with the financing that is essential for them to buy newly-issued government securities. Repos also enable other dealers to obtain these newly-issued securities from the Primary Dealers. If repo financing becomes unavailable or more costly due to adverse interpretations of the code, the distribution system for newly-issued government securities and the federal government's ability to raise funds in a cost-effective manner will be adversely affected. This would in turn increase the cost of government borrowing and the level of interest rates generally.

Wide public and private sector participation is important to the reliable functioning of the repo markets and permits the U.S. Treasury and other federal agencies to finance the country's public debt at rates of interest lower than otherwise would be possible. Moreover, it provides additional incentive for foreign central banks and other foreign holders of U.S. dollar reserves to participate in financing the nation's public debt.

Just as important, the repo market plays an important role in the conduct of monetary policy. The Federal Open Market Committee, through the Trading Desk at the Federal Reserve Bank of New York (the "New York Fed"), makes extensive use of repos in regulating the supply of funds in the execution of monetary policy. Repos have become a highly flexible and effective short-term tool for the Federal Reserve System. The effectiveness of the repo market as a tool of monetary policy depends in turn upon broad-based public participation.

As indicated above, the efficient functioning of the repo market also facilitates substantial involvement by foreign central banks, monetary authorities, and international institutions in financing the U.S. public debt. The New York Fed maintains accounts for approximately 140 foreign central banks, monetary authorities, and international institutions. With such large international holdings of the dollar, it has become important to the orderly financing of the public debt that these institutions purchase U.S. Government securities. In 1979, for example, the dollar volume of investment activity for these foreign accounts alone at the New York Fed exceeded $1.4 trillion, most of which involved U.S. Government securities. A substantial amount of this activity was a repos.

Finally, the existence of an efficient repo market in U.S. Government securities enhances the attractiveness of the U.S. dollar as an international reserve currency. The dollar is the principal reserve currency in the world.

(3) REPO MARKET IN JEOPARDY

The effective functioning of the repo market can only be assured if repo investors will be protected against open-ended market loss arising from the insolvency of a dealer or other counterparty in the repo market. The repo market is as complex as it is crucial. It is built upon transactions that are highly interrelated. A collapse of one institution involved in repo transactions could start a chain reaction, putting at risk hundreds of billions of dollars and threatening the solvency of many additional institutions.

Since the repo market is important to the health of the country's financial system, it is desirable that the Code be interpreted and implemented in a manner which protects that market without creating an unfair result for debtors. Similar concerns led to Public Law 97-222. Despite Public Law 97-222, investors in the repo market have in the last several months found themselves faced with considerable uncertainty about the treatment of repos in bankruptcy proceedings. The provisions of Public Law 97-222 are not believed adequately to protect liquidations of repos in the event of the insolvency of a dealer or other participant in the repo market, even though the principal objective of Public Law 97-222 was to prevent the insolvency of one commodities or securities firm from spreading to other firms and possibly threatening the stability of the affected market. H.R. Rep. No. 97-420, 97th Cong., 2nd Sess. 1 (1982).

The uncertainty was highlighted by the filing in the Bankruptcy Court in the Southern District of New York of a Chapter 11 bankruptcy petition by Lombard-Wall Inc. in August 1982.[2] A bench decision in the *Lombard-Wall* case held that the holder of securities subject to a repurchase agreement was subject to the automatic stay of the Code, and that this holder was precluded from closing out its position with the debtor without approval of the Court. *Lombard-Wall Incorporated* v. *Columbus Bank & Trust Co. et al. (In re Lombard-Wall Incorporated)*, No. 82 B 11556, Bankr. Ct., S.D.N.Y., bench decision, September 16, 1982. This holding made clear the risks to the market created by the Code's stay and avoidance provisions and demonstrated that Public Law 97-222 is not sufficient in scope to protect the market from major dislocations caused by bankruptcy of market participants.

The Lombard-Wall proceedings and their extensive press coverage have had an adverse impact on the financial markets and undermined the primary purposes of Public Law 97-222 because the repo market is subject to the same ripple effect as other securities markets.[3]

Uncertainty as to the scope of coverage of Public Law 97-222 with respect to the repo market has already caused special problems for certain categories of investors. The U.S. Department of Housing and Urban Development has recently decided not to

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[2] Some question about the legal status of repos in the bankruptcy context had also been raised earlier in 1982 with the collapse of Drysdale Government Securities Inc., even before the enactment of Public Law 97-222. Drysdale's failure has also had a wide impact on the repo market and in fact contributed to Lombard-Wall's problem.

[3] *See* Carrington, *Securities in Lombard-Wall Case Termed Loan Collateral by a Bankruptcy Judge*, Wall St. J., Sept. 20, 1982, at 10, col. 2.

permit further investment in repos by Public Housing Authorities, Indian Housing Authorities and FHA-Approved Mortgagees for Multifamily Projects. Standard and Poor's has suspended rating of "structured municipal issues" (which permit investment of municipal bond or note proceeds in repurchase agreements) with government securities dealers not rated by Standard and Poor's because of the questions raised by the Lombard-Wall bankruptcy about the ability of a bond or note trustee to liquidate, in a timely manner, securities held under a repurchase agreement where the seller-repurchaser files for protection under the Code.

Open-ended mutual funds, particularly the money market funds, use repos on a short term basis to assist in managing their portfolios, to provide flexibility and to provide higher return with relative safety. As of October 31, 1982, money market funds held repo agreements totalling approximately $19.4 billion.

The recent focus on safety and liquidity of repos in the event of a bankruptcy filing by a participant to a repo has raised concerns about their use by the mutual fund industry in light of the regulatory standards under the Investment Company Act of 1940. On November 4, 1982, the Securities and Exchange Commission's Division of Investment Management, in a memorandum to Chairman Shad, indicated that it would revise a previous "no action" position regarding repos and require that investment company boards of directors, to the extent practicable, evaluate the creditworthiness of the brokers or dealers with which they propose to engage in repo transactions and that it would require that government securities money market funds which advertise that their portfolio securities are government guaranteed to disclose substantial investments in repos.

While these concerns are currently being addressed within the mutual fund industry, the only certain solution at this time appears to be the proposed amendments to the Bankruptcy Code, which assure protection to the repo market participant. If a bankruptcy filing does occur, the proposed legislation would protect the liquidity of a fund's repo with a debtor, and permit the fund to achieve its bargained-for contract rights.

Safety and the ability to specify term are the key elements of repos which make them attractive to funds. Both elements promote liquidity for funds. Money market funds, by their nature, are required to be highly liquid and are used by millions of investors on a daily basis for investment in and redemption of fund shares. The ability to redeem promptly, at net asset value, is crucial to the operation of these funds and the maintenance of investor confidence. The filing of a case under the Code by a government securities dealer, or other party which holds a repo with a fund, puts these key elements in some doubt. Although there is little likelihood that bankruptcies involving fund repo would occur with any frequency, the mere possibility, under present law, raises significant issues as to the safeguards and circumstances under which funds should utilize repos in their investment portfolios.

The proposed amendments to the Code, described below, will help assure that the objective of Public Law 97-222 to minimize the displacement caused in the commodities and securities markets in the event of a major bankruptcy (128 CONG. REC. H261 (daily ed. Feb-

ruary 9, 1982) (statement of Rep. Edwards)) is carried out by expressly providing the repo market the same protection.

(4) PROPOSED REPO AMENDMENTS

The proposed amendments will take an important first step toward meeting the full objective of Public Law 97-222 by expressly providing that similar protections apply to the crucial portions of the repo market involving U.S. Government and agency obligations, certificates of deposit, and eligible bankers' acceptances. The structure of the proposed amendments is based upon the addition to the Code of new definitions of "repo participant" and "repurchase agreement" and the making of conforming changes in relevant provisions of the Code. The proposed amendments are intended to afford participants in the repo market the same treatment with respect to the stay and avoidance provisions of the Code that Public Law 97-222 explicitly provided stockbrokers, securities clearing agencies, commodity brokers and forward contract merchants in connection with securities contracts, commodity contracts and forward contracts.

The amendments would apply only to certain repurchase agreements, namely those involving certificates of deposit, eligible bankers' acceptances, or securities that are direct obligations of, or that are fully guaranteed as to principal and interest by, the United States or any agency of the United States. These amendments are not intended, however, to affect the status of repos involving securities or involving commodities as securities contracts, commodity contracts, or forward contracts, and their consequent eligibility for similar treatment under other provisions of the Code, such as the provisions giving protection to stockbrokers, securities clearing agencies, commodity brokers, and forward contract merchants for liquidation and setoff in respect of securities contracts, commodity contracts or forward contracts. In particular, a repurchase agreement as defined in the amendments, insofar as it applies to a security, would continue to be a securities contract as defined in the Code and thus also would be subject to the Code provisions pertaining to securities contracts. Similarly, insofar as a repurchase agreement as defined by the amendments applies to a commodity, it would continue to be a forward contract for purposes of the Code and would be subject to the Code provisions pertaining to forward contracts.

G. Amendments Regarding Timeshare Agreements

The Bankruptcy Code of 1978 greatly expanded the ability of the Trustee to reject executory contracts. To temper this increased power and to reflect the growing body of bankruptcy common law which provided some protection for consumer creditor interests, specific provisions were included in Section 365 to allow consumers to continue their use and enjoyment of their leases or land purchased via installment contracts. Thus, while the Trustee could still reject their contracts as executory, the consumers' interests were recognized and protected. In a similar manner and for similar reasons, these proposed amendments to Section 365 of the Bankruptcy Code of 1978 modify the Trustee's ability to reject contracts

of consumer creditors of a bankrupt timeshare developer by seeking to recognize the interests of the growing number of timeshare consumers and the need to provide these consumers with some protection in the event of a timeshare developer bankruptcy. These amendments do two things:

1. Add the definition "timeshare plan" and "timeshare interest" to Section 101 of the Bankruptcy Code; and,

2. Modify existing Section 365(h) and (i) to clearly indicate that timeshare interests are to be treated in the same manner as leases and sales of real property.

Courts have refused to extend the existing provisions to timeshare consumers because such consumers are not specifically mentioned in either paragraph and their possessory interests differ from the typical interests of lessees or contract purchasers. Because timeshare interests are difficult to characterize within existing legal concepts, it is necessary to extend the coverage of the existing consumer protections to explicitly include them.

This type of legislation is urgently needed. In February of 1982, over 700 timeshare consumers lost whatever interest they had and all moneys paid in Sherwood Hills, a timeshare resort in Utah; and, over 200 timeshare consumers lost all moneys paid to a developer who subsequently declared bankruptcy in the Sombrero Reef Club in Florida.[1] These consumer creditors do not have adequate protection. They are not businesses with the ability to spread the burden of bad debt to customers. They are not isolated consumers of a rare enterprise. Current industry estimates place the number of timeshare resorts near 1,000 and the number of timeshare consumers at over 500,000. Because this is a growing industry with the number of consumers at risk increasing at a rapid rate, the need to provide these consumers with protections already provided lessees and purchasers of real property is critical.

Subtitle G of S. 445 contains the provisions of S. 492, a bill introduced by Senators Hatch and Thurmond in January, 1983. S. 492 is essentially identical to S. 3027, which was introduced by Senator Hatch in the 97th Congress. S. 492 has also been ordered reported favorably from the Committee on the Judiciary.

In testimony before the Courts Subcommittee on January 24, 1983, Mr. Carl G. Berry, Chairman of the National Timesharing Council of the American Land Development Association stated the problem succinctly. Speaking in reference to *Sombrero Reef,* Berry stated:

* * * The Bankruptcy Court held that "right-to-use" timeshare purchase contracts were executory and could be rejected by the debtor-in-possession developer, thereby allowing the sale of the resort property free and clear of the interest of the consumer purchasers.

H. Bankruptcy Oversight

During Committee action on S. 445, it was found that administrative agencies which supervise the operations of the bankruptcy courts were lacking in certain types of information concerning the

[1] *In re Sombrero Reef Club, Inc.* 18 B.R. 612 (Bankr. S.D. Fla. 1982.)

comparative performance of courts in cases filed under the respective chapters of the Code.

In an effort to begin compiling comprehensive comparative statistics which would provide the Congress with more complete information concerning the performance of the courts in the respective judicial districts, the bill contains a directive to the Director of the Administrative Office of the United States Courts to begin assembling information concerning assets and liabilities of debtors; amount of debt discharged in cases under each chapter of title 11; the total amount of disbursements to creditors by the bankruptcy courts, and time elapsed between case filings and payments to creditors.

All of the information required to be collected under Subtitle "H" of the bill would be available from records which will be available in the bankruptcy courts from petition and motion filings, and it is the belief of the Committee that the compilations requested will pose no unmanageable burden upon the Administrative Office. The Director, of course, has complete discretion in establishing the procedures by which the information shall be gathered.

I. Technical Amendments

On July 12, 1978, the Committee on the Judiciary reported S. 2266, the Senate version of the Bankruptcy Reform Act of 1978. On September 7, 1978, the Senate took from the desk H.R. 8200, the House version of the Bankruptcy Reform Act of 1978, struck the text of the bill and inserted in its place the text of S. 2266 and passed the bill as amended. On September 20, 1978, H.R. 8200, with further amendments was passed again by the House. On October 5, 1978, the Senate repassed H.R. 8200, with additional amendments. Finally, on October 6, 1978, the House accepted the final Senate changes and cleared the bill for signature. On November 6, 1978, the bill was signed into law with the designation Public Law 95–598, the Bankruptcy Reform Act of 1978.

Since the date of passage of the Act, judges, scholars, and bankruptcy practitioners have reviewed its provisions and numerous technical amendments and minor substantive changes have been suggested to clarify the intent of Congress.

On March 14, 1979, Senator DeConcini introduced S. 658 which embodied many of those recommendations. After additional revision, S. 658 was reported out of the Judiciary Committee on August 3, 1979, passed by unanimous consent of the Senate on September 7, 1979, and sent to the House. On September 22, 1980, the House with further amendments passed S. 658 by unanimous consent. On December 1, 1980, the Senate made additional amendments to the House-passed version of S. 658 and passed it by unanimous consent. On December 3, 1980 the House with further amendments passed S. 658 by unanimous consent. On December 9, 1980, the Senate with further amendments reintroduced the bill as S. 3259 and passed it by unanimous consent. Since the House during the remainder of the 96th Congress took no action on the final Senate changes, the bill was not enacted into law.

In the 97th Congress, on April 2, 1981, Senator Dole, with Senators Heflin and DeConcini as cosponsors, introduced S. 863, which

embodied all of the provisions of S. 3259, as passed by the Senate on December 1, 1980, with a few minor changes. On April 3 and 6, 1981, general oversight hearings on the Bankruptcy Code were held by the Subcommittee on Courts, at which time testimony in support of the bill's provisions was received.

On July 17, 1981, S. 863 was passed by the Senate. However, no action was taken on the bill by the House during the 97th Congress.

On January 24th, 1983, further hearings were held on needed amendments by the Judiciary Subcommittee on Courts. At the conclusion of hearings, Senator Dole introduced the substance of S. 863, with additional provisions, as Subtitle I of the Committee bill.

Significant provisions of Subtitle I are discussed in the sectional analysis which follows this summary of the bill contents.

IV. SUMMARY AND SECTIONAL ANALYSIS OF THE BILL

A. SUMMARY

The bill is divided into ten subtitles, the content of which are as follows:

Subt. A: *Consumer Credit Amendments.* Reformed procedures relating to consumer debtor cases.

Subt. B: *Grain Elevator Bankruptcy Amendments.* Text is drawn from S. 3037 in 97th Congress. Provides procedures for expedited abandonment of grain from bankrupt elevators.

Subt. C: *Shopping Centers Bankruptcy Amendments.* S. 2297 in 97th, S. 549 in 98th. Establishes a timetable within which trustee would have to accept or reject leases on shopping center properties in bankruptcy, and other purposes.

Subt. D: *Drunk Drivers' Nondischargeability of debts.* S. 2159 in 97th Congress. Prohibits debts incurred as a result of an act of drunk driving from being discharged in bankruptcy.

Subt. E: *Referee's Salary and Expense Fund Amendments.* (Drawn from S. 863 in 97th Congress). Corrects a drafting error in the 1978 Act which requires a handful of corporate debtors in bankruptcy to continue making payments to the non-existent fund.

Subt. F: *Repurchase Agreements Amendments.* Proposal of the Federal Reserve Board, which exempts repurchase agreements from the automatic stay in bankruptcy.

Subt. G: *Timesharing Agreements Amendments.* S. 3027 in the 97th Congress, S. 492 in the 98th. This subtitle provides that persons who hold timesharing agreements shall be granted a lien on the property involved when the timesharing contractor goes bankrupt and the trustee terminates the timesharing contract, and other provisions.

Subt. H: *Bankruptcy Oversight.* This subtitle directs the Administrative Office to collect information on bankruptcy filings regarding levels of debtor income and assets, debtor living expenses, and total amounts recovered for creditors in proceedings under Chapters 7, 11, and 13. This information will assist Congress in analyzing the functioning of the bankruptcy system.

Subt. I: *Technical and Clarifying Amendments.* The bulk of the provisions in this subtitle are drawn from S. 863, which passed the

Senate by unanimous consent in 1981. The provisions correct grammatical, punctuation, and spelling errors in the code, clarify the intent of the drafters in certain sections, and generally refine procedures.

Subt. J: *Severance clause, effective dates.*

B. SECTIONAL ANALYSIS

1. Subtitle A

Sec. 201: Title.

Sec. 202(a)&(b): These sections amend sections 301 and 302 of title 11 for the purpose of creating a mechanism by which individual debtors in bankruptcy can obtain the protections of the automatic stay pending the completion of debtor counseling as provided for in Section 203 of the bill. Under the provisions of the bill, debtors would commence a case under Chapter 7 by filing a petition with the court which contains an initial designation of relief under that chapter. Upon the filing of such a petition, the debtor would have all the rights, including the right to the protections of the automatic stay, that would have been available under prior law and that would exist if the debtor were to make Chapter 7 his final designation. Similarly, a debtor would commence a case under Chapter 13 by filing a petition with the initial designation that relief was sought under that Chapter, and would have all the rights, including the right to the protections of the automatic stay, that would have been available under prior law and that would exist if the debtor were to make Chapter 13 his final designation. The only reason for referring to the initial designation as conditional is to assure that debtors receive counseling before making a final decision on whether to proceed under Chapter 7 or Chapter 13 in accordance with the new 521(a)(3) of title 11.

Sec. 202(c): This section authorizes a court to dismiss a case brought under Chapter 7 if the filing represents a substantial abuse of that Chapter. Under this provision, the court may not dismiss a case in response to a request or suggestion from any party in interest, nor may a party in interest make such a request or suggestion. Instead, the case may be dismissed only where the court, acting independently on its own motion, finds substantial abuse, and in such case, the court must make an express finding of substantial abuse.

This provision represents a balancing of two interests. It preserves the fundamental concept embodied in our bankruptcy laws that debtors who cannot meet debts as they come due should be able to relinquish non-exempt property in exchange for a fresh start. At the same time, however, it upholds creditors' interests in obtaining repayment where such repayment would not be a burden.

Crushing debt burdens and severe financial problems place enormous strains on borrowers and their families. Family life, personal emotional health, or work productivity often suffers. By enabling individuals who cannot meet their debts to start a new life, unburdened with debts they cannot pay, the bankruptcy laws allow troubled borrowers to become productive members of their communities. Nothing in this bill denies such borrowers with unaffordable

debt burdens bankruptcy relief under Chapter 7. However, if a debtor can meet his debts without difficulty as they come due, use of Chapter 7 would represent a substantial abuse.

Dismissal of a Chapter 7 filing shall be without prejudice with regard to the filing of a subsequent bankruptcy petition. Of course, the provisions of this section would apply to any subsequent filing as well. Moreover, this provision is not intended to limit the court in dealing with abuses caused by multiple filings.

On appeal of the Court's dismissal of a Chapter 7 filing, the appellate court shall accept the bankruptcy court's findings of fact unless clearly erroneous, and overrule any finding of substantial abuse which represents an error of law. No creditor or representative of a creditor may participate in judicial proceedings involving the question of whether substantial abuse exists.

Sec. 202(d): This section states Congressional intent that any dismissal of a case under the substantial abuse provisions incorporated in section 305 of title 11 by section 202(c) of this bill will not prejudice the debtor with regard to a later petition.

Sec. 203: This section provides the mechanism for debtor counseling prior to the final designation by the debtor of the chapter under which relief is requested.

When a petition is filed under either chapter, the bankruptcy court will provide the debtor with a written statement explaining that immediately prior to the meeting of creditors, the debtor will be counseled about his or her options under the bankruptcy code, and that the debtor must bring a written description of estimated income and estimated expenses to the counseling session. The statement shall also explain that the debtor must bring his or her attorney to that session, unless he or she waives this right to have counsel present.

The debtor is not required to file a statement of estimated income and expenses with the court before the counseling session so that debtors who become aware of omissions or inaccuracies during the counseling may make corrections before filing the estimated income and expense statement required by the new section 521(2) of title 11.

Counseling and the meeting of the creditors may occur sequentially on the same day so that debtors may bring their attorneys to the counseling without incurring substantial additional costs and for the convenience of the trustee. At the counseling session, trustees will inform the debtors about the relief available under Chapters 7 and 13. This will not preclude counseling, where appropriate to the situation of the debtor, of the debtor's remedies under Chapter 11. If the debtor appears capable of fashioning a reasonable repayment plan under Chapter 13, the trustee will discuss possible repayment plans. The trustee must also explain the relief the debtor could secure under Chapter 7, including which property could be redeemed and which debts would be discharged, No creditor shall be present during the counseling.

Because the counseling will be provided by officers of the court, there is a risk that debtors might view the process as an effort to discourage their initial selection or to influence their choice in one direction. To assure that the debtors clearly understand that the counseling serves only an informational purpose, trustees are re-

quired to make certain explanatory statements before they begin any counseling session. They must explain to each debtor that they are required by law to provide the information given in the counseling session to all debtors, regardless of their initial designation and regardless of their financial condition. Trustees must further explain that they cannot make any recommendations or suggestions about which chapter the debtor should select, and that the debtor may choose any option available to him. Trustees should further explain that the counseling is completely independent of the court and that they exert no influence over the proceedings in the case.

Trustess are prohibited from indicating how the court might be predisposed or might rule in any case, nor can they discuss how the court has ruled in similar cases. If questioned by a debtor about possible responses of the court, trustees should explain that they exert no influence over the court's decisions and cannot predict the court's response; where appropriate, the trustee should urge the debtor to pose such questions to counsel. The trustee may not indicate that a Chapter 7 case might be dismissed for substantial abuse.

Trustees may dispense with counseling in a case filed under Chapter 7 if, after a review of the debtor's statement of income and expenses, they conclude that the debtor's income is not regular, or that the amount of debt relative to income (or other financial considerations) make the case inappropriate for Chapter 13. This exemption assures that trustees do not waste time providing counseling in those cases where the debtor's choice of Chapter 7 is clearly the correct one.

Counseling is intended to help debtors learn about their full range of options so that they may make educated choices. Counseling is not intended to operate to a debtor's detriment. Thus, a trustee's failure to provide counseling as required under this section shall never be a basis for denying debtors relief to which they otherwise would be entitled. Nevertheless, it is the responsibility of the court to ensure that trustees perform their duties under this section, and courts shall have the power to fashion appropriate remedies, including but not limited to denial of fees, for a trustee's failure to perform such duties.

No more than ten days following the counseling session, or within such further time as may be ordered by the court, the debtor shall make a final designation of the chapter under which relief is sought. This will ensure that a final designation is made by the debtor with reasonable dispatch.

While a change in designation from the initial one selected shall be treated as a conversion under the provisions of Section 348 of title 11, no conversion costs shall be assessed against the debtor in such an event.

Sec. 204: (Deleted)

Sec. 205: The amendment requires the bankruptcy judge to convene—but not necessarily preside over—the section 341(c) meeting of creditors, and directs the court to perform such judicial functions which may be required under this title or necessary to resolve disputes arising at such meetings.

The new provisions recognize that the bankruptcy judge can perform vital judicial functions at the meeting of creditors which should be rendered as early in the bankruptcy proceedings as possible. Disputes over the scope of inquiry of the debtor, and alleged deficiencies in the debtor's petition and schedules, must be resolved by a judge. The debtor may have possession of property subject to secured claims, and the judge can direct the debtor to return such property, or can resolve questions regarding redemption. This section should be considered with section 521(3) which requires that the debtor file a statement indicating his intended disposition of collateral which is subject to security interests and make provision for such disposition at or before the meeting of creditors. It is intended that disputed matters be resolved early in the administration of the estate and without necessity for separate contested or adversary proceedings. Such proceedings impose an additional cost upon both creditors and debtors, without any corresponding benefit.

This section relates to section 524(d) which requires the bankruptcy judge to inform the debtor of the nature and effect of a discharge and reaffirmation at the hearing provided for by this section.

It is intended that this section will benefit both debtors and creditors by avoiding the need for multiple appearances in bankruptcy cases, and reducing the administrative expense and burden on the judicial system presently imposed by the necessity of holding both the meeting of creditors and separate adversary proceedings to determine issues concerning liens on the debtor's property, as well as separate discharge and reaffirmation hearings. By these changes, first meetings of creditors will have greater substance, and the debtor will be impressd more effectively with a sense of the seriousness of the judicial proceeding he is engaged in.

The court can expeditiously perform its advisory functions at such meetings by addressing groups of debtors *en masse* at the commencement of the call of the section 341 docket. Following that, the court will hold itself available for the hearing of disputed questions at the request of the parties. In this manner, the burden upon the court will be minimized while nevertheless ensuring that the debtor is aware both of the gravity of the proceedings and the supervisory role of the court.

Section 206: (a) This amendment is intended to reduce litigation revolving around valuation of consumer goods which the debtor may seek to redeem pursuant to section 722 or retain pursuant to section 1325(a)(5)(B)(ii).

Consumer goods such as furniture are those acquired for personal, family, or household use. See Bankruptcy Code section 101(7). The expectation of both consumers and creditors is that the consumer will pay for the goods out of future income and not be the proceeds of selling the property. Consumer goods usually decline in value almost immediately following purchase.

When the consumer redeems property pursuant to section 722, or seeks to use it pursuant to section 1325(a)(5)(B)(ii), the consumer is indicating a desire to continue the underlying transaction between the parties. However, there has been much unnecessary expense to

creditors and debtors in determining the value of secured property for redemption purposes.

The provisions of the new section specify the preference of the code for use of a resale market standard, with the choice of wholesale or retail measurements of value to be determined by reference to the condition of the property and the debtor's proposed use or disposition thereof. In either case, the section encourages reference to trade publications as appropriate indicia of the market value of the property in question. The language contemplates the utilization of other standards of valuation where such standards may provide for more equitable treatment of the parties than reference to the resale market would afford. For example, scheduled depreciation would be appropriate where a debtor seeks to redeem specialized manufacturing or processing equipment, peculiar to the debtor's business or profession and specialized needs, which has a limited or nonexistent resale value. In such situtations, the debtor's proposed continued use of property of substantial utility militates against the use of any valuation scheme that does not provide a return to the creditor commensurate with the benefits afforded to the debtor by the redemption provisions of the section. Conversely, where the property in question has suffered substantial depreciation and is of limited use to either the debtor or creditor, liquidation value would be appropriately applied.

Sec. 207(a): This section amends section 521 of title 11 for the purpose of specifying the debtor's duties with regard to: 1) appearing at the section 341 meeting; 2) filing a statement of estimated income and expenses; 3) making a final designation of chapter relief requested; and 4) filing a statement of intent with regard to secured property.

The new section 521(a)(4) created by subsection (a) of section 207 contains provisions dealing with the disposition of property of the debtor which is subject to a security interest or lien. When the debtor files a bankruptcy petition, property which is security for consumer debts is almost invariably in the hands of the debtor. Usually, such property will be claimed as exempt, or will be abandoned by the trustee as being of little or no value to the estate. Although the 1978 Code seemed to require the property to be delivered to the trustee, and then delivered by the trustee to either the debtor or a secured creditor, testimony in hearings held on this section showed that this often did not occur. Instead, under the Reform Act provisions, the property frequently simply remained in the debtor's possession.

The debtor has several options with respect to such property. The debtor may claim the property as wholly or partially exempt, may seek to redeem the property, or may seek to retain the property by reaffirming all or part of the underlying debt. Or, the debtor may decide to surrender the property to the secured creditor.

The provision recognizes that secured creditors have a substantial interest in such property. Accordingly, the debtor would be required to notify the secured creditor what he intends to do with the property within 10 days after the petition, and then, to perform his stated intention by the time of the meeting of creditors. If the debtor has not performed his intention by the meeting, the secured creditor is then free to enforce its lien. In situations where there is

a dispute over the respective rights of debtor and secured creditor, or in the rare case where the trustee will assert an interest of the estate in such property, the court may order the status quo to be maintained until any disputed matters are resolved.

Subsection (a)(5) complements the amendments made in § 205—that the bankruptcy judge convene the meeting of creditors. Taken together, these amendments encourage the debtor and creditor to settle issues involving secured debt without judicial proceedings, but also enable the parties to identify disputed matters at an early stage so they may be resolved at the meeting of creditors. This will avoid the time and expense of separate and delayed proceedings.

The requirement should not be burdensome to debtors since these are matters that the debtor and his counsel must review and discuss in determining whether the debtor should file bankruptcy at all and if so, whether to file in chapter 7 or chapter 13.

Sec. 207(b): (Deleted)

Sec. 208: In response to problems encountered with the federal exemptions as enacted in the 1978 Reform Act, the section amends section 522 of the code to require individuals filing in joint or consolidated cases to elect either the federal or state exemptions together, and places an aggregate limit on the value of the exemption with regard to houehold goods and personal effects of $4,000. The section also prohibits the debtor from utilizing more than $2,000 of the unused dollar value of the homestead exemption to exempt additional property not explicitly provided for by the section.

This section also amends the provisions of section 522(f) which authorize the debtor to avoid nonpurchase money security interests in property. The section should be read together with the provisions of section 722(b) which authorizes the court, upon notice and hearing, to require creditors to accept scheduled payments in redemption of the value of claims secured by nonpossessory, nonpurchase money security interests in the types of tangible personal property specified in section 522(f) over a period not exceeding 5 years.

Sec. 209(a): Section 523 is amended and expanded to address a type of unconscionable or fraudulent debtor conduct not heretofore considered by the code—that of loading up. In many instances, a debtor will go on a credit buying spree in contemplation of bankruptcy. The new subsection (d) creates a rebuttable presumption that any debt incurred by the debtor within 40 days before the filing of the petition has been incurred under the circumstances that would make the debt nondischargeable. Only that portion of a debt which was incurred within the 40-day time period is subject to this presumption. The burden is upon the debtor to demonstrate that the debt was not incurred in contemplation of discharge in bankruptcy and thus a fraudulent debt. As the language makes clear, debts incurred for expenses reasonably necessary for support of the debtor and the debtors dependents are not covered by the presumption.

Sec. 209(b): This section amends section 523 provisions governing the award of attorney's fees in cases where there is a challenge to the dischargeability of a specific debt.

The amended language provides that the court shall award attorney's fees to a debtor who prevails in a challenge to dischargeability when the court finds that the challenge was not "substantially justified." The test of whether a challenge is substantially justified is essentially one of reasonableness.

To obtain an award of attorneys' fees, a prevailing debtor must request a fee award and allege that the creditor was not substantially justified in challenging the dischargeability of the debt. To avoid a fee award, the creditor must show that its challenge had a reasonable basis both in law and in fact. The requirement that the creditor must show that it was substantially justified to avoid a fee award is necessary because it is far easier for the creditor to demonstrate the reasonableness of its action than it is for the debtor to marshal the facts to prove that the creditor was unreasonable.

Certain types of challenges may indicate that the creditor's action was not substantially justified. The court should look closely at cases, for example, where the creditor challenges the dischargeability of a debt which was incurred for expenses which were reasonably necessary for the support of the debtor or the debtor's dependents.

The standard, however, should not be read to raise a presumption that the creditor was not substantially justified, simply because it lost the challenge. Furthermore, the creditor should not be held liable where "special circumstances would make an award unjust." This "safety valve" gives the court discretion to deny awards where equitable considerations dictate an award should not be made.

Sec. 210: (a) The amendments to section 524(a) of the Code are intended to clarify congressional intent that a discharge does not operate to prohibit the enforcement of a lien upon property that has not otherwise been avoided by order of the Bankruptcy Court during the administration of the estate.

(b) The amendment to section 524(c) substantially revises the reaffirmation procedures of the 1978 act. Whereas the 1978 act required, as to reaffirmations of consumer debts, prior court approval for the agreement to be effective, the new section provides for immediate effectiveness of the agreement upon its filing with the court, subject to the court's review of the agreement pursuant to the exercise of its equitable jurisdiction. The requirement of court approval will continue to be applicable to debtors filing *pro se*. The purposes of the new section are (1) to lower the cost to the parties of the reaffirmation transaction; (2) to minimize the potential burden on the bankruptcy court, and (3) to ensure that the court is properly informed of such agreements so that it may exercise equitable powers to protect the debtor from overreaching creditors. While the purpose of the new section is to abolish the cumbersome "Miranda Warning" approach of the 1978 act, it is nevertheless intended that the court review will constitute more than a rubber stamp of the agreement. The key consideration should be ensuring that the debtor will not suffer an undue hardship by the execution of any reaffirmation agreements. In short, the debtor's fresh start should not be impaired by any such agreements.

It is anticipated that, in the vast majority of cases, the obligations of the court may be adequately discharged by brief inquiries

to counsel and the debtor. Where the debtor and the debtor's counsel are in agreement that the execution of the agreement is beneficial to the debtor, the presumption should be in favor of ratification of the agreement.

The debtor is further protected by an expanded cooling off period, which is extended to 60 days. In cases where the debtor rescinds, or the court annuls, the reaffirmation agreement, such payments as may have been made to the credit are to be returned to the debtor.

In all, the new section is designed to encourage the prompt execution and implementation of good faith reaffirmation agreements by eliminating the cumbersome and unnecessary prior approval procedures which inhibited debtors and creditors from consummating mutually acceptable debt retirement arrangements.

(c) The amendment to section 524(d) simplifies the procedure for advising the debtor of the nature and effect of discharge and reaffirmation, and directs the court to perform those functions at the meeting of creditors convened under section 341.

Sec. 211(a): Section 547(b) is amended to limit the trustee's power to avoid liens or recover payments made within 90 days of filing of the petition in bankruptcy (within 1 year in the case of an insider) unless the creditor had reasonable cause to believe the debtor was insolvent. The trustee retains the power to avoid liens and recover payments where a creditor knowingly applies last minute pressure on an insolvent debtor in the hope of obtaining more favorable treatment than the creditor would receive in bankruptcy. The amendment will permit regular payments, made voluntarily by the debtor in the ordinary course of business and prior to filing of the petition, to be retained by the creditor.

It is the purpose of preference law to promote equality among creditors and to deter creditors from applying untoward pressure to the debtor in the hope of obtaining an advantage over other creditors in a prospective bankruptcy proceeding. This section clarifies that ordinary course payments are not intended to be attached by the trustee as preferences unless the creditor had reason to believe the debtor was insolvent at the time of the transfer.

The removal of the "reasonable cause to believe" requirement from the preference section in the 1978 act had unforeseen consequences in industries dependent upon installment credit payments.

The amendment will restore the balance in the section and permit only those payments which are true preferences to be recovered.

Sec. 211(b): This section eliminates the 45 day limitation contained in section 547(c)(2). The limitation places undue burdens upon creditors who receive payment under business contracts providing for billing cycles greater than 45 days.

Sec. 212: This section conforms the numbering of section 554(c) of the Code to the provisions of the new section 521, to reflect the new section 521(a)(1) in place of 521(1).

Sec. 212(A): Conforming amendment. This section insures that a debtor's right to convert under § 706(d) of title 11 shall not be prejudiced by a change in the debtor's designation of relief pursuant to the new section 521(a)(3) of this title.

Sec. 213: The provisions of the new section 722(b) authorize a debtor, upon notice and hearing, to request an order from the Bankruptcy Court requiring the creditor to accept installment payments for the redemption of the property described in this section, for the redemption value, over a reasonable period of time not to exceed 5 years.

It is the purpose of the Code to preserve property which is necessary to the debtor's fresh start. That fresh start could be impaired if the debtor was forced to incur a high replacement cost for household goods having a low fair market value. It is inequitable to require the debtor to bear the high replacement cost of goods whose value may be relatively low.

Other provisions of the Code preserve the debtor's fresh start and protect his ability to retain collateral of the type described in this section without resorting to the harsh expedient of abolishing the lender's security interest. For example, chapter 13 allows the debtor to retain goods by paying their value over the life of the plan rather than in one lump sum. The time payment redemption is in lieu of the abolition of the lender's security interest contained in the Reform Act. Moreover, it is consistent with the original expectation of the parties that the debt would be paid out of future income, with the debtor's continued use of the property.

When the debtor is permitted to redeem in installments the court should require regularly scheduled payments sufficient in amount to insure adequate protection of secured creditors' interests in the collateral during the payment period. The calculated dollar value of that security interest should include a reasonable rate of interest upon the amount scheduled so as to protect the creditor from devaluation of his security interest during the redemption period, and to honor the contractual expectation of a reasonable compensation for the extension of credit on the original purchase. In determining what a reasonable rate of interest on the amount scheduled shall be, the court is expected to exercise sound discretion, having due regard for the expectations of the parties as embodied in the contract. The award of contract rates of interest is to be encouraged where such rates do not unduly burden the right of redemption and are consistent with interest rates prevailing, at the time of redemption scheduling, on smiliar installment contracts. However, the court may exercise its equitable powers to award lesser rates where the circumstances of the individual case dictate.

Sec. 214: This section amends section 1103(b) of title 11 to permit persons to represent an individual creditor and also a creditor's committee in a bankruptcy proceeding if there is no adverse interest. The verbatim language of this amendment was included in the 1980 Bankruptcy Amendments bill as it passed the House of Representatives on December 3, 1980.

Under present law a person, who generally is either the attorney, accountant or secretary for the creditors' committee, may not while employed by such committee, also represent any other entity in connection with the case. The provision was the result of hearings on the proposed Bankruptcy Code held in 1976, in which it was claimed that to permit simultaneous representation by an attorney, for example, of both a single creditor and the creditors' committee created an unacceptable potential for conflict of inter-

est. In theory, that potential for conflict may exist, but, in practice, implementation of the stringent standards of 1103(b) has meant significant hardship to creditors in retaining the best, most informed counsel. Experience under the Code, particularly in rural areas, has shown that the cure for the potential conflict has been at great cost and is in all likelihood worse than the disease. Present 1103(b) is an example of paternalism on the part of the Federal Government that is hardly needed in the context of chapter 11 bankruptcy proceedings between businessmen dealing at arm's length.

As a result of oversight hearings that dealt in part with this provision, the committee concludes that 1103(b) should be modified. As presently written, 1103(b)(1) assumes a conflict that usually does not exist (and which professional rules of ethics already ban); (2) excludes from administration of the bankruptcy estate those professionals who are most experienced and knowledgeable about the estate (i.e., those who are already representing individual creditors); (3) inhibits expeditious bankruptcy administration and increases the cost of administration; and (4) may inhibit out-of-court settlements which should be encouraged.

The Committee feels the amendment adequately meets the concerns of those who see a potential for conflict by precluding dual representation by those who have an adverse interest. The courts are fully capable of making this determination. The Committee also feels that mere representation by a person of one or more creditors of the same class as are represented by a creditors' committee also represented by that person shall not per se constitute the representation of an adverse interest. The court should not presume to know better than the affected creditors except in clear instances of potential impropriety.

Sec. 215: This section conforms the numbering of section 1106(a)(2) of the Code to the provisions of the new section 521, to reflect the new section 521(a)(1) in place of section 521(1).

Sec. 216: This section conforms the numbering of section 1111 of the Code to the provisions of the new section 521(a)(1) in place of section 521(1).

Sec. 217: Section 1301 of the Code imposes a stay on attempts by a creditor to recover debts of the debtor by proceeding against codebtors during the pendency of a plan. The amendment allows for automatic termination of the stay in accordance with the provisions of subsection (c) where the codebtor is notified of the creditor's intention to take action with respect to the collection of the debt from the codebtor, and the codebtor or debtor does not object. At present, the stay may be terminated in such cases, but the Code requires creditors to seek court relief to effect the termination. The new section 1301(d) thus eliminates the needless expense of a court hearing to enforce an undisputed right.

In some situations, it may not be entirely clear whether the conditions for automatic termination of the stay have occurred; therefor, the provision sets up an informal mechanism to permit creditors and debtors to resolve such matters. Thus, a creditor who believes the stay has terminated may notify the debtor and codebtor of a proposed action against the codebtor. If the debtor or codebtor notifies the creditor that he believes the stay is still in effect within 10 days, any further action against the codebtor requires

court authorization. If the debtor and codebtor fail to notify the creditor, then the creditor can carry out the proposed action.

Sec. 217(A): Conforming Amendment. This section insures that the debtor's right to dismiss under §1307 of title II shall not be prejudiced because of a change in the debtor's designation of the relief sought pursuant to the new § 521(a)(3) of this title.

Sec. 218: This amendment of section 1321 adds a new subsection (b) requiring the debtor to commence payments under chapter 13 plans upon the filing of the plan.

This change attacks the problem of debtors using depreciable property for many months in chapter 13 cases without paying anything to the lender, and then having the case dismissed or converted to chapter 7. Under the Bankruptcy Code, a considerable amount of time may elapse between the filing of the chapter 13 plan and its confirmation. No provision in the Reform Act is made for the prompt commencement of payments. In order to promote completion of chapter 13 plans as quickly as possible, payments should begin when the debtor has filed the plan that he believes he can complete. If no plan is confirmed, the payments may be returned after deducting the costs of administration.

Chapter 13 trustees report that where payments commence near the time the plan is filed there is a much greater incidence of compliance with the plan; and in fact, some courts already require this by local rule. If payments are delayed until confirmation, the debtor may become accustomed to a level of expenditures which is difficult to reduce. Under the section as amended, the period between the filing of the plan and confirmation will provide a good test of whether the debtor will be able to carry out the plan. Where commencement of payment is delayed until confirmation of the plan, debtors frequently default, or must bear the time and expense of a separate proceeding to modity the plan.

Sec. 219: This section makes several changes in the provisions of the code which regulate the requirements for chapter 13 plans.

First, the section creates a statutory declaration of congressional intent that nondischargeable claims should be paid in chapter 13 plans. This is accomplished by amendment to section 1322(a).

By amendment to section 1322(b)(1), the section permits separate classification of nondischargeable and codebtor obligations so as to facilitate payment of the amount the holders of such claims would have received but for the chapter 13 proceedings. Separate classification of claims upon which there are codebtors is warranted by the practical reality that the debtor is often compelled by circumstances to pay such claims in full. Frequently, the codebtor is a friend, relative, or employer, and will have posted collateral. If such claims are going to be paid anyway, it is important that they be considered in determining the feasibility of the plan.

Third, this section—in conjunction with section 1325(a)(6)—extends the standard plan length from 3 to 5 years. The present, 3-year provision was originally established in 1938 when maturities on consumer debts were much shorter than they are today. The option to pay over 5 years is consistent with the recent trend toward longer term credit obligations for automobiles and other consumer goods, and the increasing willingness of consumers to use second mortgage debt which may have a maturity of 10 years or

more. Since a consumer using chapter 13 is essentially seeking to convert short term debt into longer term debt, the longer maturity is eminently justified. Moreoever, the longer maturities of secured debts means that funds often will not be available to pay any substantial portion of unsecured claims during the first 2 or 3 years of a chapter 13 plan. It is only the 3d, 4th, and 5th years of a plan that meaningful payments to unsecured creditors may be expected, and the change is reflective of this fact. Thus, the longer payment period will benefit debtors (through reduced monthly payments) and creditors alike.

Sec. 220: This section addresses the requirements enunciated in section 1325(a) which must be satisfied for the court to confirm a chapter 13 plan.

Although the Code requires creditors to receive at least as much as they would receive in a chapter 7 case, this is not a meaningful standard since it looks to the consumer's nonexempt assets and most consumers have little or no nonexempt property. The good faith standard has been subject to varying interpretations as to whether (1) a minimum payment is required; (2) subjective good faith or some sort of substantial effort is necessary; and (3) all of the debtor's income which is not essential for support must be devoted to the plan.

It is the intent of the Congress to require the debtor to make a substantial effort to pay his debts. Such an effort may require sacrifices and some reduction in consumption. Thus, subsection (a) of the amendment, which adds new language to subparagraph 1325(a)(3), requires the debtor to devote that portion of his income which is not necessary for the support of the debtor and his family to the plan. It recognizes that the debtor's first obligation is that of support, but that income not necessary for support must be devoted to the plan. The amendment thus resolves the uncertainty in the case law by making it clear that (1) income not necessary for support is to be committed to the plan; and (2) no minimum payment to creditors is required.

Finally, the amendment (in subsection (d)) would require the plan to last for a period of 5 years, or to pay a reasonable portion of allowed unsecured claims. What is a reasonable portion of allowed unsecured claims is will be determined on a case-by-case basis but it is expected that the standards will closely parallel those employed for the determination of section 305 challenges in chapter 7 cases. In general, and excluding hardship circumstances, a debtor should contemplate the repayment of at least 70 percent of the allowed unsecured claims for a proposed plan that has a duration of no more than 3 years, unless the repayment of that percentage of such claims would be unfeasible even if the plan were to extend over a greater period of time.

Sec. 221: This section, by amendment to section 1328(a)(2) and (c)(2) of the Code, conforms the treatment of nondischargeable debts in chapter 13 to that accorded in chapter 7 of the Code. Under section 523(a) of Bankruptcy Reform Act, a number of claims not dischargeable in a chapter 7 proceeding were dischargeable in chapter 13 proceedings upon completion of a plan. The only exceptions were alimony and child support claims. Remaining nondischargeable debts were dischargeable even if the debtor proposed

to pay little or nothing in satisfaction of the claims, for although section 1325(a)(4) required unsecured creditors to receive as much in chapter 13 proceedings as they would in chapter 7, this provision was historically interpreted by the courts to allow chapter 13 claimants only as much as they would have received from a liquidation of the debtor's property. This standard did not, of course, consider the fact that creditors with nondischargeable claims normally have access to postpetition earnings and property. The provisions of the Reform Act encouraged debtors to propose the lowest possible payout of nondischargeable claims to assure completion of the plan, and the amendment corrects this defect in the Code by prohibiting discharge upon completion of the plan of any section 523(a) debt not paid out in the plan.

2. Subtitle B

Sec. 231: Title.

Sec. 232: This section amends section 109 of title 11 to prohibit the rescheduling of business debts of the operator of a grain storage facility in Chapter 13.

Sec. 233: Amendment to section 501 of the Code specifying the status as proof of claim of a grain storage facility receipt.

Sec. 234: Conforming amendment.

Sec. 235: Amends s. 507(a)(5) of Title 11 to substitute new language for the section. The new language creates a priority in the distribution of assets to general, unsecured creditors, in favor of farm producers who suffer loss pursuant to the sale or conversion of farm produce to or by a debtor engaged in the business of operating a farm produce storage facility. Together with the amendments made by s. 5(2) and (3) of the bill, this section restructures the distribution of assets to such creditors so as to allow farm products to participate in priority distribution after those distributions made from trustee and court expenses, wages and pension plans, and before distributions made to individuals on account of the deposit of money in connection with the purchase, lease, or rental of property or the purchase of services not delivered or provided. Thus, the priorities contained in the present section 507(a)(5) and (a)(6) are subordinated to the new priority, and the present section 507(a)(5) and (a)(6) are renumbered as (a)(6) and (a)(7) by sections 5(2) and 5(3) of the reported bill.

Sec. 236: Amends section 546 of the Code to provide greater reclamation protection for producers who have sold grain to an insolvent elevator but have not received payment. The new subsection "(d)" requires the court to secure the interest of such a producer with a lien where reclamation is denied.

Sec. 237: Amends Chapter 5 of title 11 to add a new section 557 dealing with expedited determination of interests in, and abandonment or other disposition of grain assets stored in an insolvent grain storage facility.

(a) Subsection "(b)" defines the terms "grain", "grain storage facility", and "grain storage facility receipt". The definition of grain storage facility receipt shall include, under this section, any document of the type routinely issued by the operator of a farm produce storage facility as evidence of ownership of farm produce stored in a bankrupt facility. The term includes, but is not limited to, docu-

ments known as "warehouse receipts", "scale tickets", or other similar designations provided they were issued for the purpose indicated. It is intended that resolution of the question of the purpose for which the document was issued be accomplished by reference to state or federal law (whichever is applicable), usages of trade, and the nature of the contract between the parties. It is intended only that the identity of the original bailor be required to be recorded on the face of the document, together with an adequate description of the type, quality, and quantity of grain assets represented thereby, so as to facilitate verification.

(b) Subsections "(c)" and "(d)" provide authority and direction to the court to establish a timetable for the accomplishment of the various judicial and administrative steps necessary to facilitate the expedited disposition of grain assets stored in an insolvent storage facility.

(c) Subsection "(e)" establishes the utility of a storage facility receipt as proof of ownership and right to move for abandonment or reclamation of property. Subsection "(f)" permits state or federal regulatory agencies having jurisdiction over the operation or liquidation of storage facilities involved in the bankruptcy proceedings to participate in the case. Subsection "(g)" allows expansion of the time limits for disposition of grain assets, with due regard for the interests of the parties affected by any expansion. Subsection "(h)" requires the trustee to liquidate grain assets held which exceed ten thousand bushels in amount, so as to prevent waste of the assets of the estate and to facilitate distribution. Subsection "(i)" sets forth the provisions governing appeal of orders determining interests in, or approving distribution of, grain or proceeds of grain. Subsection "(j)" codifies the prevailing practice at common law, that the interests of bailors in the fungible goods held in the estate will not be impinged upon for the benefit of secured creditors (including producers who have transferred title to the debtor but have not received payment) in any distribution of those goods. Subsection "(k)" sets forth the limits of applicability of this section to proceedings under chapter 11. Subsection "(l)" governs assessment of grain or grain proceeds for trustees costs and expenses.

Sec. 238, 239, and 240: Technical and conforming amendments.

3. Subtitle C

Sec. 251: This section provides that this title may be cited as the "Leasehold Management Bankruptcy Amendments of 1983."

Sec. 252: This section amends section 365 (a), (b), (c) and (d) and adds section 365(l) of Title 11, United States Code, as follows:

1. Section 365(a) is amended by adding the language:

The trustee shall timely perform all the obligations of the tenant arising from and after the date of the order for relief, under an unexpired non-residential lease (including payment of the rent and other charges specified in such lease) until such nonresidential lease is assumed or rejected, not withstanding the provisions of Section 503 of this title. For cause shown, the court may extend the time for performance of any obligation of rent or other charges due upon an unexpired lease pursuant to the provisions of Section 108(b) of this title. Acceptance of such performance shall not consti-

tute a waiver or relinquishment of the lessor's rights under the lease or under this title.

The purpose of this amendment is to make clear that the trustee is responsible for paying post-petition rent and other charges and performing other obligations of a non-residential lease on a timely basis until the lease is assumed or rejected.

However, where a trustee, unfamiliar with the business of the debtor, is appointed to administer the estate, and where there is reason to question the requirement to pay rent or other charges or to perform other obligations of the estate under the lease, the trustee may petition the court, and, if cause can be shown, the court may extend the time for performance of such post-petition obligations to a date no later than 60 days after the order for relief. Under Section 108(b), the trustee has 60 days after the order for relief to cure defaults and perform other similar acts.

A distinction between residential and non-residential leases is made here and in the amendment to sections 365(c), (c)(3), (d)(1), (d)(2), (d)(3), and to section 541(b).

The application of these provisions is limited to non-residential leases in order to avoid depriving residential tenants of whatever consumer protections they may have under applicable non-bankruptcy law.

This amendment also makes clear that the lessor's acceptance of such performance by the trustee does not constitute a waiver of relinquishment of the lessor's rights under the lease or under the Bankruptcy Code.

2. Section 365(b)(3) has been amended to provide that adequate assurance of future performance of a shopping center lease applies not only where there has been a default, but whenever an unexpired lease is assigned. This change is necessary because, due to a technical omission in the Bankruptcy Code, the protections for shopping centers and their solvent tenants which are provided in Section 365(b)(3) could be construed as not applying in a situation where the debtor has not defaulted on his lease and seeks to assign the lease in violation of the use clause or other provisions of the lease.

3. Section 365(b)(3)(A) is amended to require an adequate assurance that any assignee of the lease will have an operating and financial performance, including guarantors, similar to that of the original tenant when the lease was executed.

This provision is intended to prevent a shopping center lease from being assigned to another business in poor financial condition. Such a business might itself soon fail, resulting in a repetition of the problems caused by the bankruptcy of the assignor.

This provision gives the lessor and the other tenants the benefit of the original bargain with the debtor. Indicia of operating and financial performance include advertising effort, marketing style, profitability, debt rating, and ability to meet debt obligations.

4. Section 365(b)(3)(C) is amended to make clear that the assumption or assignment of a shopping center lease is subject to all the provisions of that lease, as well as to any other lease, financing agreement, or master agreement relating to the shopping center. Debtors have argued incorrected that this provision only requires adequate assurances that the provisions of such "other" leases and

agreements would not be breached, but that it would not require such assurances regarding the provisions of the lease being assigned.

5. Sections 365(b)(3) (C) and (D) are amended to delete the word "substantially" from provisions requiring that an assignment of a shopping center lease will not breach the assigned lease or other leases or agreements and will not disrupt the tenant mix.

In practice, the presence of the qualifier "substantially" has enabled trustees to ignore the use clause of leases. This violates the assigned lease and other agreements and, thereby, disrupts the tenant mix to the detriment of the other tenants of the shopping center. In 1978, Congress recognized the importance of compliance with the use clauses, and this amendment is necessary to effect Congress' intent.

6. Section 365(c)(3) has been added to provide that the trustee may not assume or assign an unexpired non-residential lease if "such non-residential lease has been terminated under state law prior to the order for relief."

The purpose of this amendment is to provide that an unexpired non-residential lease may not be assumed by a trustee, if such lease has been terminated by a state court judgment or otherwise under state law prior to the order for relief.

7. Section 365(d) has been amended to provide that in a case under any chapter of the Bankruptcy Code, an unexpired non-residential lease of the debtor is deemed rejected if the trustee does not assume or reject such lease within 60 days, or within such additional time as the court, for cause, orders.

In addition, this amendment provides that if a nonresidential lease where the debtor is the lessee is deemed rejected, "the court shall order the premises to be vacated immediately."

8. Section 365(l) is added, providing that if an unexpired lease is assigned, the lessor may require from the new tenant a security deposit for the performance of the obligations of the lease which is substantially the same as that required by the landlord upon the initial leasing and a similar tenant.

This amendment is intended to give the landlord the benefit of his original agreement with the debtor, and provide protection to the shopping center and its other tenants equivalent to that of the original bargain.

Sec. 253: This section amends Section 541 of Title 11, United States Code, to make clear that the debtor's interest in property subject to a non-residential lease which has expired by virtue of its own terms is not property of the estate and that a proceeding to obtain possession of such property is not automatically stayed by Section 362 of the Code.

This amendment is intended to permit landlords to proceed promptly in state court to reclaim possession of non-residential leased premises where such lease has expired by its own terms, i.e., because a specified termination date of the lease has been reached. This change is intended to facilitate the ability of the landlord to re-lease non-residential space to another tenant as soon as possible.

4. Subtitle D

Sec. 261: Amends section 523(a) of title 11 to prohibit the discharge of debts incurred as a result of the debtor's operation of a motor vehicle while legally intoxicated under the laws or regulations of any jurisdiction within the United States within which such motor vehicle was operated and liability so incurred.

5. Subtitle E

Sec. 271: Title.

Sec. 272: This section amends section 403(e) of Public Law 95-598 so as to place a $200,000 cap on payments to the referee's salary and expense fund in cases under section 40c(2)(a) of the bankruptcy Act pending after September 30, 1979. It also places a $100,000 cap on payments to the fund in cases under section 40c(2)(b) of the Act wherein the final determination as to the amount of the payment was not made until after September 30, 1979.

6. Subtitle F

Section 281(a): makes conforming redesignations of subsequent definitions.

Section 281(b): provides a new definition for "repo participant" in section 101. "Repo participant" includes any entity that, on any day during the period beginning 90 days before the date of the filing of the petition, has one or more outstanding repurchase agreements with the debtor with an aggregate repurchase price of $1,000,000 or more. The 90 day period is based on the preference period set forth in section 547 of the Code. This definition is intended to include an entity acting for its own account or for the account of one or more other entities (whether as custodian, trustee, fiduciary, agent or in any other capacity). It is also intended to include an entity, acting for its own account or for one or more other entities, or both for itself and for another or other entities, that may have entered into one or more repurchase agreements with a single debtor which may each involve a stated repurchase price of less than $1,000,000, but which would have an aggregate stated repurchase price of $1,000,000 or more.

It is not intended by the provisions of this definition to affect the status of agreements involving an aggregate repurchase price of less than $1,000,000 under other provisions of the Code, such as those, for example, protecting securities contracts and forward contracts.

Section 281(c) provides a new definition for "repurchase agreement" in section 101. "Repurchase agreement" means any agreement which provides for the transfer of certificates of deposit, eligible bankers' acceptances, or securities that are direct obligations of, or that are fully guaranteed as to principal and interest by, the United States or any agency of the United States against the transfer of funds by the transferee of such certificates of deposit, eligible bankers' acceptances, or securities with a simultaneous agreement by such transferee to transfer to the transferor thereof certificates of deposit, eligible bankers' acceptances, or securities as described above, at a date certain within one year after such transfers or on demand, against the transfer of funds. This definition also applies

to a reverse repurchase agreement. It also covers any related terms in a repurchase agreement (such as market-to-market provisions). For purposes of this definition an "eligible bankers' acceptance" is either (i) an acceptance by any institution of a draft or bill of exchange drawn on itself which, if drawn on a member bank, would be eligible for acceptance under the criteria established in subparagraph (A) of the seventh paragraph of section 13 of the Federal Reserve Act, 12 U.S.C. § 372, or (ii) an acceptance which, on the date the repurchase agreement is entered into, is eligible for purchase under the rules of the Federal Open Market Committee.

While repurchase agreements may be open to various kinds of characterizations and are characterized in market practice under various legal relationships, it is intended by this action that any agreement that meets the terms of the definition of repurchase agreement shall receive the treatment in bankruptcy that is provided for in this subtitle.

The definition does not require (or prevent) the original and reverse transfers to be provided for in separate agreements or confirmations. A repurchase agreement may be either written or oral.

In accordance with market practice, some repurchase agreements permit certain substitutions of the assets subject to the repurchase agreement. Accordingly, under agreements covered by this definition, the transferor may make certain substitutions of assets, but only assets of at least equal market value to those originally transferred *and* falling within the same one of the three enumerated categories (*i.e.*, certificates of deposit, eligible bankers' acceptances, or U.S. government and Federal agency issued or guaranteed securities). The transferee may return only assets that are the same in all material respects as those last transferred or substituted by the transferor.

Repurchase agreements for only certificates of deposit, eligible bankers' acceptances, and U.S. government and Federal agency issued or guaranteed obligations are afforded the amendment's treatment under the Code. As provided in section 102(5) of title 11, United States Code, the enumeration of the underlying types of property in the alternative is not exclusive; a repurchase agreement can involve the transfer or re-transfer of a combination of the enumerated kinds of property. It is not intended by the enumeration in this definition to affect in any way the status of repurchase agreements for any item, whether or not covered by the definition, under other provisions of the Code, such as those, for example, protecting securities contracts and forward contracts.

In particular, a repurchase agreement as defined in this subtitle, insofar as it applies to a security, would continue to be a securities contract as defined in the Code and thus also would be subject to the Code provisions pertaining to securities contracts. Similarly, insofar as a repurchase agreement as defined in this subtitle applies to a commodity, it would continue to be a forward contract for purposes of the Code and would be subject to the forward contract provisions of the Code.

The reference to "direct obligations of, or that are fully guaranteed as to principal and interest by, the United States or any agency of the United States" is based on section 14(b) of the Federal Reserve Act, 12 U.S.C. § 355, and is intended to include all obli-

gations of, or that are fully guaranteed as to principal and interest by, any entity whose obligations are determined by the Board of Governors of the Federal Reserve System to be eligible for purchase by Federal Reserve banks under the similar language of section 14(b) of the Federal Reserve Act.

Section 282(a): makes conforming redesignations of subsequent paragraphs.

Section 282(b): is intended to clarify that, despite the automatic stay of section 362(a), a repo participant may set off a claim for a margin or settlement payment arising out of repurchase agreements against the repo participant's obligations to the debtor in respect of cash, securities or other property that the repo participant is holding, or that is due to the debtor, to margin, guarantee, secure or settle repurchase agreements, notwithstanding the bankruptcy of the party for whose account such cash, securities, or property is held. This provision is essentially parallel to the one in existing Code section 362(b)(6).

This section refers to settlement payments as defined in section 741(8). It is intended for purposes of this section and the other provisions added by this subtitle that any amount paid or payable with respect to any interest, dividend or other distribution in respect of the certificate of deposit, eligible bankers' acceptance, or security that is the subject of the repurchase agreement and any amount paid or payable with respect to any interest, rebate or other fee in respect of the repurchase agreement, regardless of whether the amount is paid or payable on a settlement date or a different date, constitute a settlement payment within the meaning of that term as defined in section 741(8). Such items serve the same function as other, more conventional types of settlement payment and are commonly used in the securities trade. This assures consistency of treatment, since it is understood that similar amounts paid or payable with respect to securities contracts likewise come within the definition of settlement payment as defined in section 741(8) for purposes of the Code provisions relating to securities contracts.

Section 283: creates a new subsection to section 546 which, together with provisions of section 548, clarifies that a trustee is prohibited from avoiding a transfer that is a margin payment or settlement payment made by or to a repo participant in connection with a repurchase agreement, except where the transfer was made with actual intent to hinder, delay or defraud other creditors and the property transferred was not taken in good faith. This prohibition is parallel to the one in existing Code section 546(d).

Section 284: creates a new subsection to section 548(d)(2) to clarify that all margin or settlement payments made in connection with a repurchase agreement are taken for value to the full extent of such margin payments. This new provision is parallel to the one in existing Code section 548(d)(2)(B).

Section 285: makes a conforming change.

Section 286: adds a new section to the end of Chapter 5 of title 11 to clarify that the exercise of a contractual right of a repro participant to cause the liquidation of a repurchase agreement, because of a condition of the kind specified in section 365(e)(1) of title 11, shall not be stayed, avoided or otherwise limited in any proceeding

under title 11 by a court or administrative agency, unless, where the debtor is a stockbroker or securities clearing agency, such order is authorized under the provisions of the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa *et seq.*) or any statute administered by the Securities and Exchange Commission. This provision would confirm that the liquidation would terminate any right of the debtor's trustee to affirm an executory contract in respect of a repurchase agreement. The prompt liquidation of an insolvent's position is generally desirable to minimize the potentially massive losses and chain reaction of insolvencies that could occur if the market were to move sharply in the wrong direction. This provision is parallel to the one in existing Code section 555.

The amendment also contains an excess proceeds provision applicable in the event that a repo participant liquidates one or more repurchase agreements with a debtor and under the terms of one or more such agreements has agreed to deliver assets subject to such agreement or agreements to the debtor. In such an event any excess of the market prices received on liquidation of such assets (or if any such assets are not disposed of on the date of liquidation of such repurchase agreements, at the prices available at the time of liquidation of such repurchase agreements from a generally recognized source or the most recent closing bid quotation from such a source) over the sum of the stated repurchase prices and all expenses (including such items as brokerage fees, bank charges or fees for legal services) in connection with the liquidation of such repurchase agreements shall be deemed property of the estate, subject to the available rights of setoff. It is intended that the rights of setoff and other remedies permitted elsewhere in the Bankruptcy Code and under other law are not to be limited by this provision.

The new section includes a definition of the term "contractual right" in respect of repurchase agreements to make explicit that this term includes rights arising under common law, under law merchant or by reason of normal business practice whether or not evidenced in writing, as well as a right set forth in a rule or bylaw, of a national securities exchange, a national securities association, or a securities clearing agency that is applicable to each party to the repurchase agreement. It is understood and intended that such a rule or bylaw would be applicable to each party to the repurchase agreement only if each of them is a member of the exchange, association or agency promulgating the rule or bylaw or has agreed to be bound by such rule or bylaw.

Section 287: provides that these amendments shall become effective on the date of enactment but shall not apply to cases commenced before the date of enactment.

7. Subtitle G

Subtitle G of the bill modifies various sections of title 11 in order to include timeshare interests and consumers within the existing protections afforded under the Code for lessees of unexpired leases in real property of the debtor and parties to executory sale contracts.

Sec. 291: This section defines the terms "timeshare plan" and "timeshare interest".

Sec. 292: This section amends section 365(h)(1) of title 11 to afford holders of timeshare interests the same protections which are presently extended to lessees of unexpired leases in real property of the debtor under that section of the Code. Also, the language of the section is revised in order to define the parameters of the lessee or timeshare interest holder's authority to treat the lease or timeshare interest as terminated.

Sec. 293: Section 293 amends section 365(h)(2) of title 11 to include holders of timeshare interests in the provisions of that section regarding offsets for damages resulting from nonperformance of the debtor's obligations under the contract.

Sec. 294: Section 294 amends section 365(i)(1) of title 11 to include timeshare interests in the category of executory contracts covered by the provisions of that section.

8. Subtitle H

Sec. 301: This section provides authority for, and mandates, the Director of the Administrative Office, U.S. Courts, to compile certain statistical data regarding cases filed under each chapter of title 11.

9. Subtitle I

The amendments contained in subtitle "I" make amendments to title I of The Bankruptcy Reform Act of 1978, Public Law 95-598 ("the Reform Act"). In this title all section references within the section and subsection descriptions of the amendments will be to title I of the Reform Act unless otherwise indicated.

Sec. 311: (a) This section deletes a redundancy. "Substantially all the property of the debtor" includes all of the property of the debtor and "all" can be deleted as redundant.

Subsection (b). This amendment corrects a typographical error.

Subsection (c). This amendment cross-references two additional sections to complete the intent that claims fixed after the filing of the petition are to be treated as pre-petition claims, and deletes the reference to present section 502(i), which is in effect repealed by section 30(g) of the bill.

Subsection (d). This amendment corrects a typographical error in definition of "entity".

Subsection (e). This amendment corrects a typographical error in the definition of "individual with regular income".

Subsection (f). This amendment to the definition of "insolvent" with respect to a partnership, clarifies that "separate" as used in the definition refers to the general partners' nonpartnership property, and removes the ambiguity that it might refer to his non-community property in a community property estate.

Subsection (g). This amendment makes stylistic changes.

Subsection (h). This amendment makes a stylistic change.

Subsection (i). This amendment adds a definition of "United States" to section 101.

Subsection (j). This section adds definitions to section 101, for the terms "state", "forward contract", "forward contract merchant", and "financial institution".

The definition of "forward contract" will eliminate the present uncertainty surrounding the use of that term in the Code. The terms "purchase," "sale" and "transfer" are used in the definition in their broadest sense to include, at least, consignments, leases, swaps, hedge transactions, commercial options, deposits, loans, allocated and unallocated transactions, or any combination thereof.

The definition of "forward contract merchant" will eliminate the present uncertainty surrounding the use of that term in the Code.

Sec. 312: This amendment corrects a typographical error.

Sec. 313: This amendment corrects a typographical error.

Sec. 313-1: This section is a redraft of the language of Sec. 106 of title 11 relating to governmental immunities. The structure of the section is modified and the language is streamlined. No substantive change in the law is effected by the amendment.

Section 314: (a). This amendment corrects a grammatical error.

Subsection (b). This amendment is a clarifying amendment.

Subsection (c). This amendment is a clarifying amendment.

Subsection (d). Paragraph (1) of this amendment makes clear that all otherwise applicable statutes of limitations are tolled by the filing of bankruptcy petition. Paragraph (2) adds a new subsection to give taxing authorities a ninety (90) day period to act after the suspension of action created by the filing of the bankruptcy petition has expired, rather than the thirty (30) days that would otherwise be permitted. Paragraph (3) extends the statute of limitations for certain tax proceedings to sixty (60) days after the automatic stay is lifted, instead of the thirty (30) days that would otherwise be applicable.

Sec. 315: (a). The amendment makes a stylistic change.

Subsection (b). Amends section 109(b)(3) to include industrial banks in the section.

Subsection (c). Amends the language of Section 109(b)(4) to include industrial banks within the purview of the section.

Subsection (d). Stylistic change.

Subsection (e). Stylistic change.

Subsection (f). Adds a new paragraph to section 109. The purpose of the new paragraph is to provide the courts with greater authority to control abusive multiple filings. The section as amended will prohibit any party from filing a petition who, within the previous six months, has had a previous petition dismissed for failure to abide by orders of the court or upon voluntary motion for dismissal.

Sec. 316: This amendment is a stylistic change.

Sec. 317: This amendment corrects a typographical error.

Sec. 318: This amendment makes a stylistic change that clarifies section 321(b).

Sec. 319: The amendment is a clarifying amendment.

Sec. 320: (a). Amends section 326(a) to allow greater recovery for trustees in Chapter 7 and 11 cases. Testimony at the April 6, 1981 Senate Judiciary Committee hearings (Courts) revealed that the present fee system has made it very difficult to obtain private trustees in chapter 11 cases.

Subsection (b). This amendment makes a stylistic amendment to conform section 326(d) to section 102(5).

Subsection (c). Amendment provides greater flexibility for the trustee in hiring of professional persons to assist with trustee's duties. Where there is an actual conflict of interest, the trustee may not employ a party who represents a creditor in the case. This amendment is consistent with the amendment made to sec. 1103(b) of the Code.

Sec. 321: This amendment corrects a grammatical error.

Sec. 322: (a). This amendment makes a stylistic amendment to conform section 329(a) to section 102(5).

Subsection (b). This amendment is a clarifying amendment.

Sec. 323: This amendment strikes "to any parties in interest and to the United States trustee" in section 330(a) and also makes a stylistic change. All provisions relating to the United States Trustee were intended to be collected together in chapter 15 (listed separately). In that process this reference was overlooked, making the deletion necessary by stylistic change.

Sec. 324: (a). This amendment raises the amount from the filing fees in chapter 7 cases to the trustee serving in such cases from $20 to $45. The Administrative Office of the United States Courts is encouraged to develop a system of making the $45 payments that will result in the least expense and administrative work for the government. For example there could be no disadvantage to the government and the taxpayers if the $45 were paid from appropriate funds, provided the full filing fee had been received by clerk of court and deposited in the Treasury.

Subsection (b). This amendment provides in chapter 13 cases for a specified minimum monthly compensation during the administration of the plan to the trustee serving in such cases. Minimal payment plans under chapter 13 have become a financial burden upon the trustees required to administer them. This amendment will assure that the trustee is paid at least $10 per month for his services if the percentage of the monthly payments to creditors that he would be entitled to receive would be less than $10.

Sec. 325: Amends section 341(b) of title 11, to allow for meetings of equity security holders.

Sec. 326: This amendment creates a new section 342 mandating that adequate notice of any order for relief under the United States Bankruptcy laws be given, including such notice to any holder of a community claim.

Sec. 327: This amendment makes cross-referencing and typographical corrections.

Sec. 328: This amendment recognizes that the process for granting immunity under title 18 is not designed to incorporate time considerations present in bankruptcy proceedings. To this extent, therefore, provision is made for enabling the Attorney General to promulgate regulations whereby immunity, when requested, can be granted expeditiously in a bankruptcy proceeding.

Sec. 329: This amendment makes clear that depositories are authorized to give the security required for deposits of funds from the bankruptcy case as provided under section 345.

Sec. 330: (a). This amendment corrects a typographical error in section 346(c)(2).

Subsection (b). This amendment makes clear that the trustee's obligation to withhold taxes from wages and other payments by him extends to Federal, as well as state and local, taxes.

Subsection (c). This amendment makes a cross-referencing correction.

Subsection (d). This amendment conforms section 346(j) with the Bankruptcy Tax Act of 1980 (Public Law 96-589; 94 Stat. 3389).

Sec. 331: (Deleted.)

Sec. 332: This amendment makes a stylistic change.

Sec. 333: This amendment corrects typographical errors.

Sec. 334: This amendment corrects a typographical error in section 350(b).

Sec. 335: This section makes an amendment in the first alternative means of providing adequate protection by adding the option of making a one-time cash payment as an alternative to periodic cash payments. It is intended to conform with the drafting style as exemplified in section 102(7), the singular includes the plural.

Sec. 336: (a). Paragraph (1) by inserting "action or" in the phrase "other proceeding" as among those matters stayed by the automatic stay, makes only a technical change. Paragraph (2) makes a stylistic change. Paragraph (3) extends the stay of proceedings in the United States Tax Court to similar tax proceedings under State or local law.

Subsection (b). Paragraphs (1) and (2) make technical and stylistic changes. The automatic stay provided by section 362(a) applies to setoffs, enforcement of liens and actions to collect on claims against the debtor. Paragraph (3) makes stylistic changes. Paragraph (4) is intended to clarify that the exception from the automatic stay for injunctive actions by the government is to occur only in instances where there is a serious potential for harm to the public such as the debtor is polluting with toxic waste, and not the ordinary case where the government unit is simply enforcing its regulations by way of injunction. Paragraph (5) is a conforming amendment. Paragraph (6) adds two new paragraphs which add to the exception to the automatic stay for certain transactions involving the filing of a federal tax lien and Uniform Commercial Code continuation statement or of the presentment of a negotiable instrument.

Subsection (c). This amendment conforms section 263(d)(2) to section 102(5).

Subsection (d). Paragraph (1) of this amendment is a cross-reference change. Paragraph (2) makes clear that the standard provided in section 362(d)(2) for relief from the automatic stay applicable to property also applies in a chapter 13 case.

Subsection (e). This amendment makes stylistic changes.

Subsection (f). This amendment is a technical change, permitting the court to grant ex parte relief from the automatic stay, with or without a hearing.

Sec. 337: (a). This amendment makes clear that "cash collateral" as used in section 363 includes the proceeds of the secured party's collateral whether converted to cash prior to or after the commencement of the bankruptcy case.

Subsection (b). This amendment inserts a new paragraph in subsection 363(b) concerning required notification under subsection (a) of section 7A of the Clayton Act (15 U.S.C. 18a). It is a technical change.

Subsection (c). This amendment allows the court with or without a hearing to protect any interest in property under the administration of the trustee and makes a stylistic change.

Subsection (d). This amendment is a stylistic change.

Subsection (e). This amendment is a technical change.

Subsection (f). This amendment corrects a typographical change.

Subsection (g). This amendment is a technical change.

Subsection (h). This amendment corrects printing and stylistic errors in section 363(1).

Subsection (i). This amendment corrects typographical errors and makes technical changes in section 363(n).

Subsection (j). As a stylistic change, this amendment creates a new subsection delineating the burden of proof of the trustee and of the entity asserting an interest in property in any hearing under section 363.

Sec. 338: (a). This amendment makes a technical change.

Subsection (b). This amendment makes stylistic and technical changes.

Subsection (c). This amendment is a stylistic technical correction.

Subsection (d). Deleted.

Subsection (e). Deleted.

Subsection (f). This amendment enables a sublessee or leasehold mortgagee to step in the position of the debtor's lessee in the event the lessee seeks to treat the trustee's rejection as a termination. It is not intended to limit the trustee's right of rejection.

The order of choice for succeeding to a tenant's interest will be in inverse order or prioirty. This will give the junior leasehold parties the opportunity to take over the tenant's position subject to senior leasehold mortgage interests. If a junior leasehold party does not elect to succeed to the interest, his leasehold mortgagee may elect to exercise the right in order to protect the mortgage interest. For leasehold rights of equal priority such as can occur with space tenants in a building, the court will determine on a case-by-case basis the allocation of the right of succession, based upon the equities of the case and the respective hardships of each party in interest.

Subsection (g). Paragraphs (1) and (2) make stylistic changes. Paragraph 3 amends section 365(i)(2)(A) of title II in order to add a new subparagraph (3). The new subparagraph permits holders of security interests in an executory contract for the sale of real property to accede to the position of the purchser upon an election to terminate.

Subsection (h). This amendment strengthens section 365(j) from the standpoint of the estate, by granting a lien to the purchaser under an installment sale contract only for the amount of the purchase price that the purchaser has paid to or for the benefit of the debtor.

Sec. 339: This amendment is a clarifying amendment.

Sec. 340: This amendment makes a cross-referencing correction.

Sec. 341: (a). This is a technical change making clear that the creditors of a partner may object to a claim against a partnership only if the partner is a general partner.

Subsection (b). Paragraph (1) makes clear the rules governing the allowance of a reimbursement contribution claim of a co-debtor that becomes fixed after the commencement of the case which supersede the normal allowability rules for unsecured claims. Paragraph (2) makes clear that debts are to be determined in United States currency as of the date of the petition. Paragraph (3) prevents the recovery of a debt in the bankruptcy case that would not be recoverable outside of the bankruptcy court, such as can occur in the home mortgage situation where there is a State antideficiency law. Another example is the policy loan common to insurance companies. Under case law, policy loans are not debts. They cannot be recovered by the insurer. If they are not repaid, they serve to reduce the amount of benefits payable by the insured under the policy. Similarly, interest on policy loans is not recoverable and serves only to reduce the benefits paid under the policy. Paragraph (4) is a technical amendment to correct an ambiguity in this section as it may apply to the securities industry where interest may be construed to include an original issue discount. Paragraph (5) corrects conflicts between section 502(b)(3) and section 553. Paragraph (6) corrects a typographical error. Paragraph (7) make a stylistic change and makes a cross-referencing correction. Paragraph (8) corrects a typographical error and affects stylistic changes. Paragraph (9) makes stylistic changes and a change to conform to section 102(5).

Subsection (c). This is a stylistic amendment that conforms section 502(c)(2) to the definition of "claim" found in section 101(4)(b).

Subsection (d). This amendment makes cross-referencing corrections.

Subsection (e). This is a stylistic and clarifying amendment in the treatment and allowance of claims of a codebtor.

Subsection (f). This amendment makes a cross-referencing correction.

Subsection (g). This amendment would allow under section 502 a claim for any tax liability arising from payment from the estate of a claim for wages or other related income without requiring filing of proof of such a claim.

Subsection (h). This amendment permits reconsideration of a claim even after a case is closed. The claim may be reconsidered not only if it has been previously allowed but also if it has been previously disallowed.

Sec. 342: Paragraph (1), (4), (5), and (6) make minor stylistic and technical changes. Paragraph (2) and (3) make minor technical amendments regarding tax claims allowed in the expenses of the administration. Paragraphs (7) and (8) make minor technical changes. Paragraph (9) makes technical corrections to make clear

that the expenses of a creditor's committee in a reorganization case are allowable as administration expenses.

Sec. 343: Paragraphs (1) and (2) make stylistic amendments. Paragraph (1) also makes a technical amendment correcting a conflict between section 505(a)(1) and 505(a)(2) relating to the contesting of tax claims. Paragraph (3) is an amendment to conform section 505(a)(2) to section 102(5). Paragraph (4) makes a technical correction to make clear that there may be offset against tax claims, income tax refunds or credits that may be due to the estate.

Sec. 344: (a). This amendment makes clear that a nonrecourse secured creditor does not have an allowed unsecured deficiency claim to the extent that his claim is more than the value of this collateral.

Subsection (b). This amendment makes a stylistic change.

Subsection (c). Paragraph (1) makes technical correcting changes. Paragraph (2) adds a new provision, the purpose of which is to make clear that the failure of the secured creditor to file a proof of claim is not a basis for avoiding the lien of the secured creditor.

Sec. 345: (a). Paragraphs (1), (2), (3), and (4) make stylistic changes. Paragraph (5) makes a stylistic change and also rewrites the tax priority rule relating to assessments within two hundred forty (240) days of the date of the filing of the petition to make the rule clear.

Subsection (b). This is a needed amendment to make clear that the superpriority claim afforded the secured creditor for whom adequate protection later proves to be inadequate is to be paid ahead of the expenses of any superseding bankruptcy. Furthermore, the superpriority claim is to be granted whether or not any additional protection is actually given since the court could find that the collateral of the creditor at the time of the request for adequate protection is adequate and yet it later proves to have been inadequate.

Subsection (c). This amendment is a stylistic and clarifying change.

Subsection (d). Paragraph (1) clarifies the status of claimants subrogated to the position of a priority claimant. Paragraph (2) specifies rights of parties holding claims on account of a consumer's purchase from a debtor through the utilization of a credit card.

Sec. 346: (a). This amendment makes stylistic changes.

Subsection (b). This amendment makes stylistic changes.

Subsection (c). This amendment makes a technical cross-reference change in section 509(c).

Sec. 347: This amendment corrects a typographial error and makes a clarifying amendment. It makes clear that the subordination of a rescission claim for stock cannot be below the common stock class.

Sec. 348: (a). This amendment is a clarifying amendment.

Subsection (b). This amendment is a clarifying amendment.

Sec. 349: (a). This amendment is a clarifying amendment.

Subsection (b). This amendment makes technical changes in the effect of the exemptions upon a tax lien.

Subsection (c). This amendment makes stylistic and clarifying changes.

Subsection (d). This amendment is a clarifying amendment.

Subsection (e). This amendment is a clarifying amendment.

Subsection (f). This amendment is a clarifying amendment.

Subsection (g). This amendment is a clarifying amendment.

Subsection (h). This amendment makes cross-referencing changes.

Subsection (i). This amendment is a clarifying amendment.

Subsection (l). This amendment adds a new subsection to section 522 to make clear that the State or local exemption law to be applied in the bankruptcy case is that law in effect generally upon the date of the order of relief as opposed to the State or local exemption law that might have been in effect at the time a particular lien arose or at the date the debtor acquired the property.

Sec. 350: (a). Paragraph (1) makes a stylistic change in the false financial statement exception to discharge. Paragraphs (2) and (4) make cross-referencing changes.

Subsection (b). This amendment makes a cross-referencing change.

Subsection (c). This amendment makes a cross-referencing change.

Sec. 351: (a). This amendment makes two stylistic changes to the injunction provision of section 524(a).

Sec. 352: This section amends section 525 of title 11 to extend the protections against discrimination to persons employed in the private sector. Under this section, no private employer may terminate employment of or discriminate with respect to employment against any person on the basis that that person has been or will be a debtor in bankruptcy, or has suffered insolvency pending a discharge.

Sec. 353: (a). Paragraph (1) corrects a typographical error. Paragraph (2) makes a stylistic change. Paragraph (3) adds to the property of the estate any recovery of the trustee under section 363(n), which permits recovery against collusive bidders at a trustee sale. This is a technical amendment. Paragraph (4) makes a grammatical change. Paragraph (5) conforms section 541(a) to section 102(5).

Subsection (b). This amendment makes technical amendments to the antiforfeiture provision in section 541.

Subsection (c). This amendment is a clarifying amendment.

Subsection (d). This amendment deletes section 541(e). Its provisions have been replaced by a new section 555 created by section 56(a) of this bill.

Sec. 354: This amendment makes a stylistic change.

Sec. 355: (a). This amendment makes a technical change.

Subsection (b). This amendment makes technical changes.

Subsection (c). This amendment makes technical changes.

Subsection (d). This section amends section 543(d) for the purpose of providing certainty to business transactions involving an assignee if within four months neither the debtor nor the creditor seeks to replace the assignment.

Sec. 356: This amendment makes clarifying changes and makes clear that a trustee's rights and powers under the strong arm clause are in the alternative rather than in the conjunctive.

Sec. 357: This amendment corrects typographical errors and makes clarifying amendments.

Sec. 358: (a) This amendment is an amendment to conform section 546(a) to section 102(5).

Subsection (b). This amendment is a necessary clarifying change.

Subsection (c). Paragraphs (1), (2), (3), and (4) make stylistic and typographical corrections. Paragraph (5) is a clarifying amendment.

Subsection (d). Conforming amendment.

Sec. 359: (a). This amendment makes clarifying and stylistic changes.

Subsection (b). This amendment makes a clarifying change.

Subsection (c). Paragraphs 1–6 of this amendment make stylistic and typographical corrections. Paragraph (7) adds a new paragraph to section 547(c) of title 11 for the purpose of clarifying the status of payments upon letters of credit. The purpose of the provision is to overrule the decision in *Twist Cap Inc.* v. *Southeast Bank of Tampa*, 1B.R 284(Fla. 1979). Under the section as amended, a payment on an irrevocable letter of credit, commitment to lend funds, note purchase agreement, or bond of indemnity issued by the credit guarantor in the ordinary course of the credit guarantor's business and in accordance with the terms of the credit guaranty agreement would not be voidable by the trustee as a preference.

Subsection (d). This amendment makes stylistic changes.

Subsection (e). This amendment makes clear that equitable liens are to be treated like other liens and be avoidable by the trustee in bankruptcy.

Subsection (f). As a stylistic change, this amendment adds a new subsection to section 547 delineating the burden of proof of the trustee under section 547(b) and of the party in interest under section 547(c).

Sec. 360: (a). Paragraph (1) corrects a stylistic error in the fraudulent transfer section. Paragraph (2) corrects an inadvertent omission in the Federal codification of the Uniform Fraudulent Conveyance Act.

Subsection (b). This amendment makes a stylistic change.

Subsection (c). This amendment would make a necessary technical change, which conforms the time within which a security interest may be perfected so as to be insulated from the trustee's power to set it aside as a preferential transfer to that provided for in the Uniform Commercial Code.

Subsection (d). This amendment makes stylistic changes.

Sec. 361: (a). This amendment corrects a typographical error and makes a stylistic change.

Subsection (b). This amendment makes stylistic changes.

Subsection (c). This amendment makes stylistic changes.

Subsection (d). This amendment is an amendment to conform section 549(d)(1) to section 102(5).

Sec. 362: (a). This amendment makes clarifying cross-referencing corrections.

Subsection (b). This amendment makes a stylist change.

Subsection (c). Paragraphs (1) and (2) make stylistic changes. Paragraphs (3) and (4) correct an error of duplication in the definition of "improvement" in section 550(d).

Subsection (d). This amendment makes an amendment to conform section 550(e)(1) to section 102(5).

Sec. 363: This amendment makes clear that section 551 was not intended to overrule the case of *First National Bank* v. *Staake,* 202 U.S. 141 (1960).

Sec. 364: This amendment makes clarifying changes.

Sec. 365: This amendment corrects a cross-referencing error in section 553(b)(1)

Sec. 366: (a). This amendment makes a technical change.

Subsection (b). This amendment makes a stylistic change.

Subsection (c). This amendment corrects a typographical error.

Sec. 366: (a) Conforming amendment.

Sec. 367: (a). This amendment creates a new separate section 555 for defenses of the estate, replacing section 541(e). Section 541(e) is deleted by this bill.

Subsection (b). This amendment makes conforming amendments to the table of sections of the United States Code.

Sec. 368: This amendment corrects a typographical error.

Sec. 369: (a). This amendment makes a stylistic change.

Subsection (b). This amendment makes a typographical correction and a stylistic change.

Subsection (c). This amendment makes a stylistic change.

Sec. 370: This amendment makes stylistic changes.

Sec. 371: This amendment requires the trustee to file interim reports with the court so that all interested parties can be informed as to the progress of the administration of the case. It is a technical correction. Two tyopgraphical changes are also made.

Sec. 372: This amendment makes stylistic changes making the conditions for dismissal under chapter 7 disjunctive and not conjunctive.

Sec. 373: (a). This amendment makes a technical change in section 723(a).

Subsection (b). This amendment makes necessary and technical clarifying changes and a typographical correction in section 723(c).

Sec. 374: (a). This amendment corrects an error in the anticircuitry of liens provisions relating to avoidance of the tax lien. It makes clear that priority payments unpaid under section 724(b)(2) will be paid before the tax claim is paid under section 724(b)(5).

Subsection (b). This section makes a technical stylistic change.

Subsection (c). This amendment makes stylistic changes.

Sec. 375: This amendment makes a stylistic change.

Sec. 376: (a). Paragraphs (1), (2), (3), and (4) make stylistic changes. Paragraph (5) provides for payment of interest based on either the contract rate or the legal rate, whichever is applicable on any claim distributed under paragraphs (1), (2), (3), and (4) of

section 726(a). This prevents a liquidation proceeding from being a vehicle for a solvent debtor to escape the obligation to pay a contract rate of interest.

Subsection (b). This amendment makes clarifying stylistic changes.

Subsection (c). This amendment also makes the same change in another provision as was made in paragraph (1) of subsection (b).

Sec. 377: (a). This amendment corrects typographical errors and makes a clarifying stylistic change.

Subsection (b). This amendment makes a stylistic change.

Subsection (c). This amendment is an amendment to conform section 727(e)(2)(A) to section 102(5).

Sec. 378: (a). This amendment makes a minor stylistic change.

Subsection (b). This amendment makes a minor stylistic change.

Sec. 379: Stylistic changes and conforming amendments.

Sec. 380: This amendment makes a stylistic change.

Sec. 381: (a). This amendment corrects a typographical error and makes stylistic changes.

Subsection (b). This amendment corrects a cross-referencing error.

Sec. 382: Conforming amendments.

Sec. 383: This amendment makes a stylistic change.

Sec. 384: (a). This amendment makes stylistic changes.

Subsection (b). This amendment makes a conforming change.

Sec. 385: This amendment makes cross-referencing and stylistic changes.

Sec. 386: (a). This amendment makes technical changes.

Subsection (b). This amendment makes stylistic and cross-referencing changes.

Subsection (c). This amendment makes a cross-referencing change.

Sec. 387: By this amendment a correction is made in the municipal adjustment chapter, chapter 9, limiting section 552 as it would apply to revenue bonds issued by a municipality. Cross-referencing changes are also made.

Sec. 388: This amendment makes stylistic changes.

Sec. 389: This amendment corrects a typographical error.

Sec. 390: This amendment corrects a typographical error.

Sec. 391: This amendment makes typographical corrections.

Sec. 392: (a). This amendment makes stylistic changes.

Subsection (b). This amendment makes cross-referencing changes.

Sec. 393: (a). This amendment makes stylistic changes.

Subsection (b). This amendment makes technical changes.

Sec. 394: This amendment conforms the confirmation standard for chapter 9 with respect to the payment of administrative expenses to the same rules as found in chapter 11.

Sec. 395: This amendment makes a stylistic change.

Sec. 396: This amendment is a clarifying amendment.

Sec. 397: Paragraph (1) makes clear that the creditors' committee is not required to make recommendations with respect to the plan

and may solicit rejections as well as acceptances. Paragraph (2) deletes redundant language in section 1103(c).

Sec. 398: This amendment makes a necessary grammatical change.

Sec. 399: This amendment gives the court explicit power to regulate the duties of an examiner.

Sec. 400: This amendment makes clarifying changes.

Sec. 401: This amendment makes a clarifying change. The court may not ex parte order the trustee or debtor in possession to cease operating the debtor's business.

Sec. 402: This amendment makes clear that a deficiency claim will be eliminated only when the secured creditor has had an opportunity to credit bid the claim. The amendment adds abandonment or surrender of the collateral to the secured creditor as the possible events that would eliminate the deficiency claim.

Sec. 403: (a). This amendment makes a technical clarifying change and corrects a typographical error.

Subsection (b). this amendment makes stylistic changes.

Sec. 404: (a). This amendment makes a grammatical change.

Subsection (b). This amendment makes a technical stylistic change.

Sec. 405: (a). Paragraphs (1) through (5) make technical stylistic changes.

Subsection (b). This amendment makes necessary stylistic changes.

Sec. 406: This amendment makes stylistic changes.

Sec. 407: (a). This amendment makes clarifying amendments.

Subsection (b). This amendment makes clarifying amendments.

Subsection (c). This amendment makes stylistic changes.

Sec. 408: (a). This amendment corrects a cross-referencing error.

Subsection (b). This amendment makes a stylistic change.

Subsection (c). This amendment makes typographical stylistic changes.

Subsection (d). This amendment makes a necessary clarifying change in section 1126(g).

Sec. 409: (a). This amendment makes stylistic changes.

Subsection (b). This amendment makes stylistic changes.

Sec. 410: (a). Paragraphs (1) through (6) make clarifying and stylistic changes. Paragraph (7) makes a stylistic change. The Code is keyed to "holders of claims" for style as opposed to "creditors." Paragraph (9) makes clear that a government taxing unit may be required to accept certain tax payments over a period of six (6) years following confirmation of a plan of reorganization. The extension provisions are broadened to include taxes that result from the sale of a capital asset, the recapture of an investment tax credit, the recapture of depreciation, or a similar event. This provision is particularly important in a reorganization plan where the debtor has for a period of years had substantial unrealized income as a result of capital gain. This is common in the instance where a farmer seeks to reorganize and use the sale of all or a major part of his farm to pay the debts provided for under the plan of reorganization. Without this sort of provision, the capital gains taxes due upon the sale of the farm are immediately due upon confirmation

of the plan. As a result many plans cannot go forward. If these taxes can be extended over a six (6) year period like other taxes in the reorganization case, the farmer is able from other income to make such payment and the plan of reorganization can be confirmed. This amendment in no way forgives or cancels any such taxes nor will the government receive less than the full amount of its claim. Paragraph (10) makes clear the intent of section 1129(a)(10) that one "real" class of creditors must vote for the plan of reorganization.

Subsection (b). Paragraph (1) deletes a confusing and ambiguous cross-reference in section 1129(b)(1) which resulted from earlier drafts of the Code. Paragraphs (2) and (3) make necessary technical changes omitting certain priority claims from the cram-down for unsecured claims. Paragraph (4) makes a technical correction.

Subsection (c). This amendment makes stylistic changes and places the burden of proof on the government on the issue of avoidance in any hearing under section 1129(d).

Sec. 411: (a). This amendment makes clearer that the minority in a senior class that has by majority voted for subordination is bound by the order confirming the plan notwithstanding the requirement that the court enforce subordination agreements in section 510(a).

Subsection (b). This amendment makes stylistic changes.

Sec. 412: (a). This amendment makes a stylistic change.

Subsection (b). This amendment conforms section 1142 to section 102(5).

Subsection (c). This amendment makes a stylistic change.

Subsection (d). This amendment makes stylistic and typographical changes.

Sec. 413: This amendment makes a stylistic change.

Sec. 414: (a). Paragraph (1) makes a clarifying change. Subsection 1145(a) confuses separate aspects of initial distribution and resale. Without this amendment, section 1145(a) could be interpreted to restrict the issuance and distribution of securities by underwriters at both the initial distribution and secondary stages, which was not the intent of Congress. The effect of the amendment will place controls on underwriters at the resale stage where they are appropriate. Paragraph (2) deletes the "affiliate" limitation in the portfolio exception consistent with the intent of Congress to allow the debtor to make the fullest use of his assets to generate operating funds in the chapter 11 case. Paragraphs (3) and (4) contained in sections 1145(a)(3)(B) (i) and (ii) are overly restrictive. Securities of issuers who are required to comply with the reporting provisions of the Securities Exchange Act by virtue of section 15(d) should be eligible for the exemption provided by section 1145. Those amendments effect that purpose. Paragraphs (5) and (6) change section 1145 to correspond to a recent change by the Securities and Exchange Commission of the timing requirements of analogous rule 144. Paragraph (7) corrects typographical error.

Subsection (b). This amendment corrects a typographical error and makes stylistic changes.

Subsection (c). This amendment makes clear that the exception applies to any note provided that the maturity is no longer than 1 year from the effective date of the plan. "Com-

mercial" is not a defined concept in the Code and it is deleted as superfluous.

Sec. 415: (a). This amendment makes a technical change.

Subsection (b) This amendment conforms section 1146(d)(1) to section 102(5).

Sec. 416: This amendment makes a technical change.

Sec. 417: This amendment makes a cross-referencing change.

Sec. 418: This amendment makes a stylistic change.

Sec. 419: This amendment makes a cross-referencing change.

Sec. 420: (a). This amendment makes a stylistic change.

Subsection (b). This amendment makes a stylistic change.

Subsection (c). This amendment makes stylistic change.

Sec. 421: This amendment makes a stylistic change.

Sec. 422: (a). This amendment makes a stylistic change.

Sec. 423: (a) This amendment makes a stylistic change.

Subsection (b). This amendment makes a stylistic change.

Subsection (c). This amendment creates a new subsection 1302(d) which terminates the stay when the plan is filed to the extent that the plan does not pay the creditor's claim. In so doing, it eliminates the needless expense required to enforce an undisputed right.

Sec. 424: (a). This amendment adds a new paragraph (3) to section 1302(b) concerning trustee handling of monies under chapter XIII cases of the old Bankruptcy Act.

Subsection (b). This amendment makes stylistic changes.

Sec. 425: This amendment makes a stylistic change.

Sec. 426: This amendment makes a stylistic change.

Subsection (b). This amendment makes stylistic changes.

Sec. 427: (a). This amendment makes clear that secured tax claims are to be paid under the chapter 13 plan.

Subsection (b). This amendment makes stylistic changes.

Sec. 428: This amendment makes a clarifying stylistic change.

Sec. 429: This amendment makes a stylistic change.

Sec. 430: (a). This amendment makes a stylistic change.

Subsection (b). This amendment allows the court upon the filing of the case to order any entity from whom the debtor receives income to pay the trustee all or part of such income.

Sec. 431: This amendment makes a necessary stylistic change.

Sec. 432: Paragraph (1) in the revocation of discharge section of chapter 13 makes clear that fraud as a ground for revocation of discharge must be fraud by the debtor and not by any other party. Paragraph (2) makes a stylistic conforming amendment.

Sec. 433: This amendment makes stylistic changes.

Sec. 434: This amendment makes a stylistic change.

Sec. 435: This amendment makes cross-referencing changes.

Sec. 436: This amendment corrects a typographical error and makes a stylistic change.

Sec. 437: This amendment corrects a typographical error.

Sec. 438: This amendment is a technical clarifying amendment.

Sec. 439: (a). This amendment creates a new section which allows trustees in chapter 13 cases to call a meeting of creditors. It is not to be interpreted as refecting that U.S. trustees may not call meetings in other than chapter 13 cases.

Subsection (b). This amendment is a conforming amendment.

Sec. 440: This amendment makes a cross-referencing change.

Sec. 441: This amendment makes stylistic changes.

Sec. 442: This amendment makes stylistic and cross-referencing changes.

Sec. 443: This amendment makes a similar amendment to that made in section 60 of the bill so that it is clear that interested parties in U.S. trustee districts as well as in non-U.S. Trustee districts will receive interim reports on the condition of the estate during its administration.

Sec. 444: This amendment makes a stylistic change.

Sec. 445: (a) This amendment creates two new sections concerning the duties of trustee and examiner and the trustee's authorization to operate the debtor's business.

Subsection (b). This amendment is a conforming amendment.

Sec. 446: (a) This amendment makes a stylistic change.

Subsection (b). This amendment makes cross-referencing changes.

10. Subtitle J

Sec. 447: Severance Clause.

Sec. 448: Effective date.

V. Budget and Regulatory Impact; Cordon Rule

A. BUDGET IMPACT

U.S. Congress,
Congressional Budget Office,
Washington, D.C., April 21, 1983.

Hon. Strom Thurmond,
Chairman, Committee on the Judiciary, U.S. Senate, Dirksen Office Building, Washington, D.C.

Dear Mr. Chairman: Pursuant to Section 403 of the Congressional Budget Act of 1974, the Congressional Budget Office has prepared the attached cost estimate for S. 445, the Omnibus Bankruptcy Improvements Act of 1983.

Should the Committee so desire, we would be pleased to provide further details on this estimate.

Sincerely,

Alice M. Rivlin,
Director.

Congressional Budget Office—Cost Estimate, April 21, 1983.

1. Bill number: S. 445.

2. Bill title: Omnibus Bankruptcy Improvements Act of 1983.

3. Bill status: As ordered reported by the Senate Committee on the Judiciary, April 19, 1983.

4. Bill purpose: The bill amends various sections of the Bankruptcy Act.

Subtitle A would require the bankruptcy judge to convene but not necessarily preside over the section 341(c) meeting of creditors and would simplify the procedure for advising the debtor as to the nature and effect of discharge and reaffirmation. This advisory procedure would be incorporated into the section 341 meeting of credi-

tors. A threshold test would be required to determine if a debtor may file under chapter 7. The test would apply only when a creditor challenge is made before the 341 hearing. In addition, this section would require the debtor to compile an accurate statement of income, current living expenses and family support, and chapter 13 repayment plans would be extended to five years.

Subtitle B is intended to expedite the proceedings for determining the disposition of grain assets. Subtitles C and D amend the Bankruptcy Act regarding the responsibility of trustees in cases involving shopping center leases, and limit action in bankruptcy proceedings in cases where debts were incurred as a result of drunk driving. The bill, in Subtitle E, would limit the fees paid to the Treasury in certain cases under the previous bankruptcy law. The remaining sections of the bill affect procedures regarding repurchase and timeshare agreements, and bankruptcy oversight, and make technical and clarifying changes to the existing bankruptcy law.

5. Estimated cost to the Federal Government: CBO estimates that additional expenditures by the federal government as a result of enactment of this bill will be approximately $5 to $18 million in fiscal year 1984, and $5 to $14 million annually thereafter, with gradual increases for inflation. The government will also lose about $7 million annually in receipts as a result of increased compensation to bankruptcy trustees. In addition, the bill would result in the loss of at least $22 million in fees currently owed to the government and otherwise likely to be collected over the next several years.

Basis of estimates: It was assumed that this bill would become law by July 1, 1983, and as required by the bill, would become effective three months later on October 1, 1983. CBO also assumed that all funds authorized would be appropriated. All costs would begin to be incurred in fiscal year 1984.

Changes required by Subtitle B would add to the workload of judges and the staff of the bankruptcy courts. This workload could be accommodated by a reduction in the number of cases processed or by providing additional resources to the bankruptcy court system in order to maintain the current caseload. The CBO has estimated that to maintain the current output level of the bankruptcy courts, approximately 84,000 additional hours of judicial time would be needed in the first year. This should decrease somewhat in the following years as the courts and creditors become more familiar with the new process. The estimated cost of providing the additional judicial time would be between $5 and $18 million in the first year, and $5 to $14 million in subsequent years, with gradual increases for inflation. This estimate is based on various staffing options suggested by bankruptcy judges surveyed by CBO. The options include increasing the number and duties of trustee coordinators to a ratio of one coordinator per two judges (approximately $5 million in the first year), adding an additional law clerk judge (approximately $8 million in the first year) or creating 65 additional bankruptcy judgeships (approximately $18 million in the first year). In the first two options it has been assumed that the additional staff would be able to relieve the judges of certain duties and workload sufficient enough to allow them the needed additional ju-

dicial time. The last option assumes creating additional judgeships sufficient to meet the estimated increase in required judicial time.

Amendments included in Subtitle E, which limits fees paid to the Treasury, would result in the loss of approximately $22 million in fees currently owed. This estimate is based on three cases which have been identified as being affected by these amendments. While there is no precise way to predict the number of additional cases which are affected, it is not likely that the additional loss in fees would exceed $3 to $4 million. In addition, amendments in Subtitle I would reduce fees paid to the Treasury by approximately $7 million annually. This results from the increasing of compensation to bankruptcy trustees by $25 per Chapter 7 filing.

Other sections of this bill would not signficantly increase the costs to the judicial system or to the Department of Justice.

The costs of this bill fall within budget function 750.

6. Estimated cost to State and local governments: None.

7. Estimated comparison: None.

8. Previous CBO estimate: None.

9. Estimate prepared by: Jeff Nitta (226–2860).

10. Estimate approved by:

JAMES L. BLUM,
Assistant Director for Budget Analysis.

B. REGULATORY IMPACT EVALUATION

In compliance with rule XXVI, paragraph 11(b) of the Standing Rules of the Senate, the Committee finds that no significant regulatory impact as defined by that subsection will result from the enactment of S. 445.

C. CHANGES IN EXISTING LAW

In the opinion of the Committee on the Judiciary, it is necessary in order to expedite the business of the Senate to dispense with the requirements of paragraph 12 of Rule XXVI of the Standing Rules of the Senate, relating to the showing of changes in existing laws made by the bill as reported. The committee feels this is justified as the changes made by this bill are obvious and a further explication of their effect on existing law is not necessary.

VI. ADDITIONAL VIEWS OF MESSRS. METZENBAUM AND KENNEDY

Any revisions of our bankruptcy laws must be placed in historical perspective. For nearly a century debtors in this country, overwhelmed by their financial troubles, have been able to obtain a fresh start by surrendering most of their valuable assets. This right to a fresh start was designed, in the words of the Supreme Court, to provide "A new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt." *Local Loan Co.* v. *Hunt*, 292 U.S. 234 (1934).

As originally introduced, S. 445 represented a radical departure from this century-old bankruptcy tradition. In the name of curing a few well-publicized abuses of the Bankruptcy Code, a well-orchestrated creditor lobby attempted to turn back the clock on basic bankruptcy protections. Instead of a fine-tuned approach designed to weed out possible abuses, creditors attempted a broad assault on our Bankruptcy Code.

At the core of that assault was the so-called "future income test." Under that test debtors would be denied bankruptcy relief unless they could demonstrate an inability to pay back past debts out of their future income over a three to five year period. Such a test would have forced a debtor to mortgage his or her future in order to obtain bankruptcy relief. And it would have hit hardest at working people, minorities, women—all those whose very livelihoods have been threatened by the disastrous economic downturn of recent years.

Creditors also originally sought to reverse major bankruptcy reforms passed by Congress in 1978. These reforms were adopted at that time to insulate debtors from severe creditor harassment. While we agreed that some adjustments in the 1978 act were necessary to keep a proper balance between debtor and creditor interests, no need for wholesale reversal of the 1978 reforms was demonstrated.[1]

In recognition of the fact that S. 445 went too far in tipping the balance against debtors, the bill was significantly modified during its two years of committee consideration. While we are not completely satisfied with the bill as amended by the committee, some of its worst aspects have been eliminated. Most importantly, the future income test has been completely deleted. The bill now provides for credit counseling for the debtor. It also includes authority

[1] Creditors attribute their increased bad debt losses to enactment of the 1978 Bankruptcy Act. but the record reflects a different reason for their increased losses. Their losses are higher because the volume of debt outstanding is up so much. Actually, the number of bankruptcies per dollar of credit outstanding hs been lower since enactment of the 1978 reforms than in the years prior to those reforms. In short, creditors are losing more because they are lending more, not due to any changes in the Bankruptcy Code. See testimony of Bankruptcy Judge Joe Lee on Apr. 6, 1983.

for the court, strictly on its own motion, to dismiss Chapter 7 filings where not to dismiss would represent substantial abuse of the Bankruptcy Code. It is our hope that, used appropriately, this new authority in the Bankruptcy Court will not jeopardize the traditional right of debtors to wipe their slate clean of past debts and obtain a fresh start for the future.

The bill is improved over the original legislation in other respects as well.

The Federal exemptions have been preserved while clear-cut loopholes in those exemptions have been closed.

Existing protections requiring court approval of reaffirmation agreements have been maintained for debtors not represented by attorneys.

While not all property typically subject to finance company liens will, as under current law, be insulated from repossession, that protection will continue to apply to all health aids and to tools of the trade up to $1,000 in value. The courts will also retain the ability to avoid liens on household goods where the court finds that payment of the redemption value of the property is not possible and enforcement of the lien would impose undue hardship on the debtor.

The presumption that debts incurred prior to filing for bankruptcy were fraudulently incurred—the so-called "loading up" provision—has been limited to a reasonable 40-day period and does not include debts incurred for expenses which were reasonably necessary for the support of the debtor or the debtor's dependents.

Finally, the bill, as reported, will require the award of attorney's fees to debtors that prevail against a creditor's challenge to discharge where the creditor was not substantially justified in making the challenge. Although this gives debtors less protection than under current law, it is a distinct improvement over the bill in its original form which would have precluded such awards to the debtor in virtually every instance.

In our opinion, the bill, as finally reported, still tips the balance unnecessarily in favor of the creditors. Other than in the areas of loading up and loopholes in the current Federal exemptions, which had unintentionally permitted debtors to retain too much property when they filed for bankruptcy, we do not feel the record demonstrates a need for significant change. Moreover, it hardly seems appropriate for the balance to be struck in favor of creditors given the buffeting consumers have taken in recent years from inflation, high interest rates and record post-war unemployment. If legislation is to be enacted, however, we are satisfied that the bill as reported is a significant improvement over the measure that was originally introduced in the 96th Congress.

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